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THE REGULATORY FLEXIBILITY ACT OF 1980: AN ESSENTIAL PROTECTION FOR SMALL BUSINESS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE REGULATORY FLEXIBILITY ACT OF 1980: AN ESSENTIAL PROTECTION FOR SMALL BUSINESS

OCTOBER 17, 1989

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October 17, 1989:

Morning session 1

THE REGULATORY FLEXIBILITY ACT OF 1980: AN ESSENTIAL PROTECTION FOR SMALL BUSINESS

TUESDAY, OCTOBER 17, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 9:38 a.m. in room SR-428A, Russell Senate Office Building, Hon. Malcolm Wallop (Acting Chairman) presiding.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **GRASSLEY**. Call the meeting of the Committee together. I am Senator Grassley, and I am here to help Senator Wallop who is necessarily detained. He will be here at about 10:15 a.m. but he did not want to hold up the entire meeting until he could be here. I want to apologize for his not being here and tell you that I am happy to take his place.

I appreciate an opportunity for this Committee to consider S. 1458. I commend Senator Wallop for introducing this bill, which will amend the Regulatory Flexibility Act. As a co-sponsor of this legislation, of course, I strongly support this effort.

The need to amend the Reg Flex to reflect the very least of what was our original congressional intent, is well overdue. The fact that the IRS has effectively exempted itself from the act is clear evidence that more congressional action is needed.

In the last Congress, the Taxpayers Bill of Rights was enacted into law. In an early version of that bill, Senators Pryor, Reid, and I included a provision that would have subjected the IRS to the Regulatory Flexibility Act. I do not have to tell you that this provision provoked extraordinarily strong opposition from the IRS and the Treasury Department.

In the interest of passing many other aspects of this legislation, the Reg Flex provisions were modified to require that all new regulations that affected small business be reviewed by the Small Business Administration. Perhaps our guests from the SBA will be able to comment on whether and to what extent this law has been implemented. I thank all the witnesses for appearing today, and I look forward to their testimony.

[The prepared statements of Senators Wallop, Boschwitz, Burns, Bumpers, and Dixon follow:]

STATEMENT BY SENATOR MALCOLM WALLOP
BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS
TUESDAY, OCTOBER 17, 1989
OVERSIGHT HEARING ON THE REGULATORY FLEXIBILITY ACT

TODAY I AM PLEASED TO CHAIR THIS OVERSIGHT HEARING ON THE REGULATORY FLEXIBILITY ACT. I APPRECIATE THE COOPERATION OF THE CHAIRMAN, SENATOR BUMPERS, IN ALLOWING ME TO DO SO WITHOUT A CO-CHAIRMAN. IN RECENT MONTHS, I HAVE RECEIVED LETTERS FROM A NUMBER OF WYOMING'S SMALL BUSINESSES AND CHAMBERS OF COMMERCE ABOUT THE NEED TO APPLY THE REGULATORY FLEXIBILITY ACT TO INTERPRETATIVE RULES, THE MOST PERTINENT EXAMPLE BEING SECTION 89. ALSO HERE WITH US TODAY FROM TORRINGTON, WYOMING IS JOHN VANDEL, A REPRESENTATIVE OF ONE OF THOSE SMALL CIRCLES WHO WILL DISCUSS HIS FRUSTRATION WITH GOVERNMENT REGULATIONS WHICH HAVE CIRCUMVENTED THE REG-FLEX PROCESS.

I HAVE ALSO HEARD FROM A NUMBER OF GAS STATION OWNERS AND OPERATORS IN WYOMING ABOUT THE PROBLEMS THEY ARE CONFRONTED WITH AS A RESULT OF THE UNDERGROUND STORAGE TANK REGULATIONS PROMULGATED BY EPA. ESSENTIALLY, EPA IS REQUIRING GAS STATION OWNERS TO ACQUIRE LIABILITY INSURANCE THAT IS SIMPLY NOT AVAILABLE IN WYOMING AND I AM AFRAID THAT SOME OF THOSE STATIONS MAY BE FORCED OUT OF BUSINESS. AS IS OFTEN THE CASE, CONGRESS IS FORCED TO BEAR THE RESPONSIBILITY FOR THE FAILURE OF MANY AGENCIES TO COMPLY WITH THE REG FLEX ACT. AS A RESULT, WE ARE NOW ATTEMPTING TO ENACT LEGISLATION INTRODUCED BY MY FRIEND AND COLLEAGUE, SENATOR BURNS, TO DELAY THE IMPLEMENTATION OF THESE REGULATIONS.

THE PURPOSE OF THIS HEARING IS TWOFOLD. FIRST, I BELIEVE IT AFFORDS US AN IMPORTANT OPPORTUNITY TO PROVIDE CONGRESS WITH INFORMATION ABOUT THE EFFECTS OF THE REGULATORY FLEXIBILITY ACT ON REDUCING REGULATORY BURDENS. SINCE ITS ADOPTION IN 1980, THIS IS ONLY THE SECOND OVERSIGHT HEARING WE HAVE HELD ON THE ACT, THE FIRST BEING IN AUGUST, 1982. SECOND, IT WILL ALLOW US TO CAREFULLY EXAMINE WHAT CHANGES SHOULD BE MADE.

ALTHOUGH THE REGULATORY FLEXIBILITY ACT HAS BEEN INSTRUMENTAL IN TAILORING A GREAT NUMBER OF REGULATIONS TO THE NEEDS OF SMALL BUSINESSES, THE LAW AS ENACTED LEFT SEVERAL QUESTIONS ABOUT ENFORCEABILITY UNANSWERED. FOR EXAMPLE, REG-FLEX DOES NOT PROVIDE FOR JUDICIAL REVIEW, THEREFORE INJURED SMALL BUSINESSES HAVE NO RECOURSE IN THE COURTS.

ALSO, THE ACT DOES NOT COVER INTERPRETATIVE RULES, MANY OF WHICH ARE ISSUED BY THE INTERNAL REVENUE SERVICE. AS A RESULT, WE HAVE SPENT THE MAJORITY OF THIS YEAR DEALING WITH SECTION 89. THIS ISSUE ALONE CALLS FOR LEGISLATIVE CHANGES TO PROVIDE US WITH THE PROPER REGULATORY FOCUS ORIGINALLY CALLED FOR IN THE LAW.

AS MY COLLEAGUES MAY BE AWARE, I RECENTLY INTRODUCED S. 1458 WHICH SUGGESTS THREE CHANGES TO THE ACT TO ADDRESS ITS SHORTCOMINGS: JUDICIAL REVIEW AFTER A REGULATORY FLEXIBILITY ANALYSIS HAS BEEN COMPLETED, INCLUSION OF IRS INTERPRETATIVE RULES AND A MODIFICATION OF THE DEFINITIONS TO INCLUDE THE INDIRECT EFFECTS OF REGULATIONS WHEN A REGULATORY ANALYSIS IS UNDERTAKEN. ALTHOUGH MY BILL HAS BEEN REFERRED TO THE JUDICIARY COMMITTEE, THIS HEARING SHOULD PROVIDE AMPLE FODDER FOR ITS FUTURE CONSIDERATION.

THE PRIMARY GOAL OF MANY OF OUR PREVIOUS ADMINISTRATIONS HAS BEEN TO CURB REGULATORY RED TAPE. IN MY VIEW, THIS IS ONE AREA WHERE CONGRESS CAN PLAY A MAJOR ROLE IN PROVIDING IMPORTANT RELIEF TO SMALL BUSINESSES WHICH MIGHT NOT OTHERWISE SURVIVE IN TODAY'S COMPETITIVE ENVIRONMENT. AS MR. VANDEL, A SMALL RETAIL DRUGGIST, WILL POINT OUT, THE FAILURE OF GOVERNMENT REGULATORS TO CONFORM REGULATIONS AND PAPERWORK BURDENS TO THE SIZE AND RESOURCES OF A BUSINESS CAN BE EXTREMELY COSTLY IN TERMS OF BOTH TIME AND MONEY.

ILLUSTRATIVE OF THIS EXAMPLE IS THE HEALTH CARE FINANCING ADMINISTRATION'S FAILURE TO PERFORM A REGULATORY FLEXIBILITY ANALYSIS ON PRICE CHANGES FOR DRUGS UNDER THE MEDICAID PROGRAM. THIS RESULTED IN A MUCH NARROWER PROFIT MARGIN FOR MR. VANDEL'S BUSINESS. AS A STRONG ADVOCATE OF OUR FREE ENTERPRISE SYSTEM, I AM PARTICULARLY PLEASED TO PARTICIPATE IN THIS DISCUSSION AND TRUST IT WILL BE USEFUL IN DETERMINING HOW WE CAN BRING ABOUT LESS GOVERNMENT INTERFERENCE AND MORE FLEXIBILITY TO OUR REGULATIONS WHILE ENSURING THAT THEY CONFORM TO THE LAW.

I WELCOME THREE OF OUR DISTINGUISHED WITNESSES FROM THE HOUSE SIDE TODAY, CONGRESSMEN SISISKY, IRELAND AND UPTON, ALL OF WHOM HAVE SPONSORED LEGISLATION TO AMEND THE REGULATORY FLEXIBILITY ACT. I LOOK FORWARD TO THEIR TESTIMONY AS WELL AS THAT OF THE OTHER WITNESSES WHO HAVE GRACIOUSLY DEVOTED THEIR TIME AND EFFORTS TO THIS HEARING. I'D ALSO LIKE TO COMMEND FRANK SWAIN, THE OUTGOING CHIEF COUNSEL FOR ADVOCACY, WHO HAS GIVEN HIS BLOOD, SWEAT AND TEARS TO THE REGULATORY FLEXIBILITY ACT. I FOR ONE WILL MISS THE KNOWLEDGE AND ENERGY FRANK BRINGS TO HIS JOB AND WELCOME HIM TO THE COMMITTEE TODAY.

STATEMENT OF SENATOR RUDY BOSCHWITZ
BEFORE THE SENATE SMALL BUSINESS COMMITTEE
OCTOBER 17, 1989

SENATOR WALLOP, I WANT TO COMMEND YOU FOR CONDUCTING THIS HEARING ON S. 1458, YOUR LEGISLATION TO AMEND THE REGULATORY FLEXIBILITY ACT. I AM A COSPONSOR OF THIS BILL WHICH I BELIEVE WILL BE MOST BENEFICIAL TO SMALL BUSINESS BY ELIMINATING SOME OF THE REGULATORY BURDENS IMPOSED UPON IT. I WOULD LIKE TO WELCOME OUR DISTINGUISHED PANEL OF WITNESSES TODAY WHICH INCLUDES REPRESENTATIVES OF THE SMALL BUSINESS COMMUNITY AND U.S. REPRESENTATIVES SISISKY, IRELAND AND UPTON.

THIS LEGISLATION WILL PROVIDE THREE BASIC CHANGES TO THE REGULATORY FLEXIBILITY ACT. THE FIRST WILL REQUIRE A SMALL ENTITY ANALYSIS FOR INTERPRETATIVE RULES. CURRENTLY, AGENCIES ARE REQUIRED TO PERFORM AN ANALYSIS OF PROPOSED RULES TO DETERMINE THEIR IMPACT ON SMALL BUSINESSES. MANY AGENCIES DON'T PERFORM THE SMALL ENTITY ANALYSIS BECAUSE THEY CLASSIFY MANY PROPOSED RULES AS INTERPRETATIVE, AND INTERPRETATIVE RULES ARE EXEMPT FROM THE REGULATORY FLEXIBILITY ACT.

AN EXAMPLE OF A PROPOSED RULE WHICH WAS DETERMINED TO BE INTERPRETATIVE WAS SECTION 89, A PROVISION OF THE TAX REFORM ACT OF 1986. IF THE INTERNAL REVENUE SERVICE HAD NOT CLASSIFIED THIS RULE AS INTERPRETATIVE AND HAD PERFORMED THE SMALL ENTITY ANALYSIS, THEY WOULD HAVE REALIZED THE NEGATIVE IMPACT THIS COULD

HAVE ON THE SMALL BUSINESS COMMUNITY. S. 1458 WOULD NO LONGER EXEMPT THESE INTERPRETATIVE RULES.

THE SECOND CHANGE WILL ALLOW A SMALL BUSINESS TO REQUEST A JUDICIAL REVIEW OF AN AGENCY DECISION. PRESENTLY, AFTER AN AGENCY PERFORMS THE SMALL ENTITY ANALYSIS AND IT DETERMINES THERE IS NO SIGNIFICANT IMPACT TO SMALL BUSINESS, NO JUDICIAL REVIEW OF THE DECISION IS PERMITTED. THERE IS NO WAY TO CHALLENGE AN AGENCY'S DECISION WHEN IT CLAIMS THERE IS NO IMPACT; THE AGENCY CAN SIMPLY MAKE A UNILATERAL DECISION. S. 1458 WOULD PROVIDE FOR THIS MUCH-NEEDED JUDICIAL REVIEW.

THIRDLY, THE REGULATORY FLEXIBILITY ACT DOES NOT TAKE INTO ACCOUNT THE INDIRECT IMPACT REGULATIONS MAY HAVE ON THE CUSTOMERS OR CLIENTS OF SMALL BUSINESSES. IN ORDER FOR A SMALL BUSINESS TO COME INTO COMPLIANCE WITH A FEDERAL AGENCY RULE, IT IS ENTIRELY POSSIBLE IT MAY HAVE TO INCREASE ITS PRICES, RATES, ETC.; THUS, HAVING AN INDIRECT IMPACT ON ITS CLIENTS AND CUSTOMERS. YOUR LEGISLATION WILL CONSIDER THIS INDIRECT IMPACT.

AS A COSPONSOR OF S. 1458, I FIRMLY BELIEVE THE SMALL BUSINESS COMMUNITY CAN BE ASSISTED BY THESE CHANGES TO THE REGULATORY FLEXIBILITY ACT. I THANK MY DISTINGUISHED COLLEAGUE FROM WYOMING FOR INTRODUCING THIS BILL AND I LOOK FORWARD TO WHAT, I HOPE, WILL BE FAVORABLE TESTIMONY FROM THE WITNESSES.

THANK YOU.

SMALL BUSINESS

HEARING

THE REGULATORY FLEXIBILITY ACT IMPACT ON REDUCING REGULATORY BURDENS ON SMALL BUSINESSES

SEN. CONRAD BURNS

OCTOBER 17, 1989

MR. CHAIRMAN, I COMMEND THE COMMITTEE FOR HOLDING THIS HEARING TODAY BECAUSE IT IS IMPORTANT THAT WE UNDERSTAND THE DIRECT IMPACT THAT ACTIONS (OR INACTION) OF FEDERAL AGENCIES CAN HAVE ON SMALL BUSINESS OWNERS IN JUST ABOUT EVERY SEGMENT OF OUR ECONOMY.

ONE OF THE MAJOR EXAMPLES WITH WHICH I HAVE BECOME VERY FAMILIAR WITHIN THE PAST SEVERAL MONTHS HAS TO DO WITH THE ENVIRONMENTAL PROTECTIVE AGENCY. LATE LAST YEAR, EPA PUBLISHED TWO SETS OF REGULATIONS THAT AFFECT UNDERGROUND PETROLEUM STORAGE TANKS.

THE FIRST SET, HAVING TO DO WITH THE TECHNICAL STANDARDS THAT TANK OWNERS HAVE TO MEET, WAS A VERY REASONABLE SET OF REGULATIONS BECAUSE A LONG LEAD TIME WAS ALLOWED FOR TANK OWNERS AND OPERATORS. THE SECOND SET, HOWEVER, HAS PROVEN TO BE A DISASTER FOR SMALL BUSINESS OWNERS ALL ACROSS THE COUNTRY.

THESE REGULATIONS, PROVIDING FOR FINANCIAL RESPONSIBILITY REQUIREMENTS, ARE TOTALLY UNREALISTIC AND IN MY OPINION, UNREASONABLE. EPA IS REQUIRING SMALL INDEPENDENT PETROLEUM MARKETERS TO BUY POLLUTION LIABILITY INSURANCE FAR ABOVE WHAT THEY CAN AFFORD. WHILE THE CONGRESS SET THE AMOUNT (1,000,000.) CONGRESS DID NOT TELL EPA TO REQUIRE THIS LEVEL OF INSURANCE THIS SOON.

THE FIRST KICK-IN DATE IS ONLY NINE DAYS FROM NOW, ON OCTOBER 26. POLLUTIONS LIABILITY INSURANCE IS IN MANY AREAS OF THE COUNTRY EXTREMELY DIFFICULT TO OBTAIN OR, AT THE VERY LEAST, EXTREMELY EXPENSIVE.

THE POINT, MR. CHAIRMAN, IS THAT THIS PARTICULAR CLASS OF SMALL BUSINESS OWNER, INDEPENDENT PETROLEUM MARKETERS, IS WORKING HARD TO COMPLY WITH EPA'S TECHNICAL STANDARDS BY UPGRADING AND REPLACING THEIR UNDERGROUND TANKS. ONCE THOSE TANKS ARE UPGRADED AND REPLACED, THEN IT WILL BE EASIER TO DEMONSTRATE FINANCIAL RESPONSIBILITY BY OBTAINING APPROPRIATE LEVELS OF POLLUTION LIABILITY INSURANCE.

BUT EPA HAS IT BACKWARDS -- THEY ARE MAKING THE FINANCIAL RESPONSIBILITY REGULATIONS EFFECTIVE PRIOR TO THE TECHNICAL STANDARDS.

TO ADDRESS THIS ISSUE, I HAVE INTRODUCED S. 1560, A BILL WHICH WOULD DELAY FOR ONE YEAR THE IMPLEMENTATION OF THE FINANCIAL RESPONSIBILITY REGULATIONS. THIS ONE YEAR DELAY WOULD ALLOW STATES TO MOVE AHEAD IN PASSING AND

OBTAINING EPA APPROVAL OF THEIR OWN STATE FUNDS. IT WOULD ALLOW TIME FOR INDEPENDENT MARKETERS TO CONTINUE TO REPLACE AND UPGRADE THEIR TANKS.

FINALLY, IT WOULD ALLOW THE POLLUTION LIABILITY INSURANCE MARKET TO "SHAKE OUT" SO THAT THERE COULD BE SOME HOPE OF STABILITY IN TERMS OF AVAILABILITY, PREMIUMS, ETC. MY MONTANA COLLEAGUE, CONGRESSMAN MARLENEE, HAS INTRODUCED IDENTICAL LEGISLATION IN THE HOUSE (H.R. 3321).

CONGRESS RECOGNIZED THAT THESE FINANCIAL RESPONSIBILITY REQUIREMENTS MIGHT PROVE UNWORKABLE, AND SO EPA, BY LAW, HAS THE AUTHORITY TO SUSPEND ENFORCEMENT OF THESE REQUIREMENTS IN SIX-MONTH INCREMENTS.

DESPITE ALL KINDS OF PLEAS FROM MARKETERS AND THE HILL, EPA REFUSES TO EXERCISE THAT AUTHORITY. THIS LACK OF REGULATORY FLEXIBILITY BY EPA PROVIDES A GOOD EXAMPLE OF HOW GOOD CONGRESSIONAL INTENT CAN GET SIDETRACKED BY AN AGENCY WHICH REFUSES TO RECOGNIZE REALITY AND EXERCISE SOME COMMON SENSE.

STATEMENT of SENATOR DALE BUMPERS

Hearing on
Implementation of the Regulatory Flexibility Act of 1980

Committee on Small Business

October 17, 1989

This morning, the Small Business Committee is meeting to review the recent implementation of the Regulatory Flexibility Act of 1980 and to receive recommendations for making the Act more effective. I commend my colleague from Wyoming for taking the lead in this important effort.

Regulatory and paperwork burdens imposed by Government are persistent concerns to the small business community. It costs them time and money, often with clear public purpose. It reduces their competitiveness in the markeplace, which is growing increasingly global. We will hear those themes many times today from the representatives of the small business community, simply because they are valid and important.

This year the Committee has devoted substantial attention to regulatory and paperwork burdens. In June, I chaired a hearing on the paperwork burdens heaped on the small business community by OSHA's Hazard Communication Standard. That was a classic case where an agency was so blinded by its drive to attain a worthwhile goal that it lost all sight of the practicalities involved. Obviously, neither the Regulatory Flexibility Act nor the Paperwork Reduction Act were applied as the Congress intended.

In September, Senator Dixon's Paperwork Reduction Subcommittee took a broader look at the implementation of the Paperwork Reduction Act (PRA) by the various executive agencies. The small business community made clear its support for vigorous enforcement of the PRA as an important shield to the small business community. They also stated their strong support for the Office of Information and Regulatory Affairs (OIRA) within OMB, which is up for reauthorization.

During that hearing, Frank Swain, the Chief Counsel for Advocacy, emphasized the interplay between the Paperwork Reduction Act and the Regulatory Flexibility Act. With teamwork between SBA's Office of Advocacy and OIRA (O-eye-rah), the small business community stands a better chance of avoiding the flood of regulatory and paperwork requirements which would engulf them if the various departments and agencies were left unchecked.

Today, the Committee will be focusing on the implementation of the Regulatory Flexibility Act by the executive agencies. Any discussion of "RegFlex" focuses a spotlight on SBA's Office of the Chief Counsel for Advocacy, which exercises a critical role in the Act's implementation. Since the Act became effective at the beginning of the tenure of the current Chief Counsel for Advocacy, Frank Swain, he has had a great deal to do with the shaping of its practical application. His efforts have been marked by dedication, imagination, and a good deal of hard-nosed negotiation with the various agencies. His assessment of the

Act's implementation by them and his recommendations for improvement deserve the close attention of this Committee and the Committee on the Judiciary, which has jurisdiction over the Regulatory Flexibility Act.

We will also be hearing much testimony today concerning the provisions of S. 1548, Senator Wallop's bill to strengthen the Act in many important respects. It is my intention to furnish copies of the record from today's hearing to the Committee on the Judiciary.

I look forward to today's witnesses from the Congress, the Administration, and most importantly the small business community.

OCTOBER 17, 1989

STATEMENT BY ALAN J. DIXON

SMALL BUSINESS COMMITTEE

HEARING ON REGULATORY FLEXIBILITY ACT OF 1980 AND ITS IMPACT ON SMALL BUSINESS

MR. CHAIRMAN, THIS MORNING WE HAVE THE OPPORTUNITY TO REVIEW THE REGULATORY FLEXIBILITY ACT OF 1980. I COMMEND THE CHAIRMAN FOR HOLDING THIS HEARING. THIS SESSION WILL PROVIDE THE COMMITTEE THE OPPORTUNITY TO EXAMINE HOW THIS IMPORTANT PIECE OF LEGISLATION IS BEING IMPLEMENTED. ADDITIONALLY, THIS HEARING WILL ALSO ALLOW US TO FOCUS ON HOW WE CAN STRENGTHEN THIS LAW TO MORE FULLY ACHIEVE THE INTENT -- THAT BEING TO ENSURE THAT FEDERAL REGULATIONS DO NOT DISPROPORTIONATELY BURDEN SMALL BUSINESS CONCERNS.

THE REGULATORY FLEXIBILITY ACT WAS A KEY RECOMMENDATION OF THE 1980 WHITE HOUSE CONFERENCE ON SMALL BUSINESS. WHEN CONGRESS PASSED THIS BILL INTO LAW, WE RECOGNIZED THAT FEDERAL REGULATIONS WERE UNNECESSARILY BURDENSOME TO SMALL BUSINESSES. TO PREVENT THIS, THE ACT REQUIRES THAT THE FEDERAL GOVERNMENT PERFORM AN ANALYSIS ON PROPOSED RULES TO DETERMINE THEIR EFFECT ON SMALL BUSINESS CONCERNS. THIS REVIEW SYSTEM IS ABSOLUTELY NECESSARY. AS I HAVE STATED BEFORE, THE PROPENSITY OF THE GOVERNMENT TO HEAP PAPERWORK

BURDENS ON LARGE AND SMALL BUSINESSES ALIKE IS LEGENDARY, AND MUST NOT GO UNCHECKED.

MR. CHAIRMAN, LAST MONTH I HELD A HEARING IN MY SUBCOMMITTEE OF GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION ON A VERY SIMILAR ISSUE -- THE IMPLEMENTATION OF THE PAPERWORK REDUCTION ACT OF 1980. ONE OF TODAY'S WITNESSES, FRANK SWAIN, CHIEF COUNSEL FOR ADVOCACY FOR THE SMALL BUSINESS ADMINISTRATION, NOTED DURING THAT HEARING THAT THE PAPERWORK REDUCTION ACT AND THE REGULATORY FLEXIBILITY ACT WERE COMPLEMENTARY TOOLS TO RESTRAIN THE GOVERNMENT'S PAPERWORK BURDEN ON SMALL BUSINESSES. THE TESTIMONY OF THAT HEARING CLEARLY INDICATED THE STRONG COMMITMENT OF THE SMALL BUSINESS COMMUNITY FOR THE CONTINUATION, AND STRENGTHENING, OF THE PAPERWORK REDUCTION ACT. I FULLY EXPECT THAT TODAY'S WITNESSES WILL AFFIRM THE SAME COMMITMENT FOR THE REGULATORY FLEXIBILITY ACT. CONTINUED CONGRESSIONAL OVERSIGHT AND LEGISLATIVE INITIATIVES ARE THE SMALL BUSINESS COMMUNITY'S BEST HOPE FOR AN EFFECTIVE RESTRAINT ON THE BURDENS UNNECESSARILY IMPOSED ON SMALL BUSINESS CONCERNS.

I LOOK FORWARD TO THE TESTIMONY OF TODAY'S WITNESSES FROM THE CONGRESS, THE ADMINISTRATION, AND THE SMALL BUSINESS COMMUNITY. I HOPE THAT THIS HEARING WILL PROVIDE US WITH THE OPPORTUNITY TO ACCESS THE IMPORTANCE OF THIS TOOL, AND ALSO PROVIDE PRACTICAL SUGGESTIONS AS TO HOW WE MAY BEST STRENGTHEN AND PRESERVE THE ACT. THANK YOU, MR. CHAIRMAN.

Senator **Grassley**. It is my pleasure to introduce to the audience the Honorable Norman Sisisky, Chairman of the House Subcommittee on Exports, Tax Policy and Special Problems of the House Committee on Small Business; the Honorable Fred Upton, Fourth District, Michigan, also a Member of the House Committee on Small Business; and the Honorable Andy Ireland, Ranking Minority Member of the House Subcommittee on Exports, Tax Policy and Special Problems of the House Small Business Committee.

I know at least two of you very well. As to the third, I am glad to get acquainted. I would ask you to go in whatever order you wish, presumably the order in which I introduced you.

STATEMENT OF HON. NORMAN SISISKY, A U.S. REPRESENTATIVE FROM THE STATE OF VIRGINIA

Representative **Sisisky**. Thank you, Senator Grassley. I have a 10 a.m. appointment, so if I may go first? I would ask that my entire statement be placed in the record, if you will.

Senator **Grassley**. It will be.

Representative **Sisisky**. I thank you for the opportunity to address this Committee on the efforts being made in Congress to amend the Regulatory Flexibility Act. I applaud the leadership shown by this Committee in holding this hearing and raising this issue.

I appeared before this Committee several months ago to discuss the Hazard Communication Standard and the burden that regulation imposes on small business. I also recently appeared before Senator Dixon's Subcommittee to support the reauthorization of the Paperwork Reduction Act, which minimizes the Government paperwork demanded of small businesses. Today I am here to support amending the Regulatory Flexibility Act.

The best example of the importance of the Regulatory Flexibility Act is the way in which the Hazard Communication Standard was promulgated. The Hazard Communication Standard negatively affects thousands of small businesses. However, for a variety of reasons including a court challenge, no regulatory flexibility analysis was ever completed. The resulting regulation shows how little the regulating agency, OSHA, understands the world in which the average small business must operate.

The Regulatory Flexibility Act, Senator Grassley, is an important check on Government redtape. The Regulatory Flexibility Act recognizes that the effect of a proposed rule or regulation on small business is not always the first thing that regulators consider when drafting regulations. The problem is that the law requires agencies to analyze the regulatory impact of a proposed rule on small business; however, without judicial review there is nothing to ensure that Federal agencies comply in good faith with both the requirements and the spirit of the law.

I am particularly concerned by the fact that the Internal Revenue Service is exempted from the requirements of the act. Anyone who owns or operates a business knows that IRS regulations are often the most complex, cumbersome, and costly of all. Yet, because IRS rules are "interpretive"—and I use quotes—the IRS is excused from considering the cost and effect of proposed rules on small business.

The Regulatory Flexibility Act should both include a right to judicial review and bring the IRS under the act. Mr. Ireland and I have introduced legislation, H.R. 2292 and H.R. 2293, designed to accomplish this end.

Along with our legislation, I should also mention the efforts of Representative Upton from Michigan and, of course, Senator Wallop, who have each introduced legislation that, if passed, would help achieve this goal.

Now before I go any further, I would like to acknowledge the leading role that my good friend and colleague, Andy Ireland, has played in raising the issues of the Regulatory Flexibility reform. We must make Regulatory Flexibility a viable tool for protecting small business. To put it bluntly, if we expect the law to work, we have to give it teeth.

Clearly, part of the solution to the problem is for better congressional oversight of both Federal agencies, including IRS, and on its own actions. Congress, for example, should avoid future fiascoes like Section 89. The resulting interpretive rules for Section 89 proposed by IRS were unbelievably complex and burdensome. Much of the blame for the regulatory mess, however, rests with Congress. Nonetheless, the IRS and other Federal agencies should be accountable for how well regulatory cost and complexity is minimized.

Allowing full judicial review, in my opinion, will achieve this goal, and specifically requiring the IRS to conduct a Regulatory Flexibility analysis during interpretive rulemaking will protect taxpayers from IRS regulatory excesses.

Senator Grassley, anyone who has operated a small business, indeed every taxpayer, knows that IRS rules are complex and time consuming. The estimate times required to comply with IRS requirements are, often as not, vastly underestimated. America's small businesses are directly responsible for most of the new jobs created in this country. America's small businesses are the innovators in new technologies and services that America needs to compete in the global economy.

Further, the ability to own a small business lies in the very heart of the American dream. Small businesses, however, are being crippled by excessive Government regulations that do not fully recognize the unique role that small business plays in our national economy. Government bureaucrats who have never had to work in or operate a small business in the real world are shortsighted when designing regulations that affect these businesses. A strengthened Regulatory Flexibility Act will go far in protecting small business against governmental caprice.

Let me again thank you for holding this hearing and for your interest in this vital topic. Regulatory Flexibility and Paperwork Reduction go hand in hand. The two laws, in my opinion, complement each other and reflect a legislative recognition of the special problems and the special unique role played by small business in our national economy. I look forward to working with you on this issue.

[The prepared statement of Representative Sisisky follows:]

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STATEMENT OF HON. NORMAN SISISKY CHAIRMAN, HOUSE SMALL BUSINESS SUBCOMMITTEE ON EXPORTS, TAX POLICY AND SPECIAL PRBLEMS, BEFORE THE SENATE SMALL BUSINESS COMMITTEE

WASHINGTON, D.C.
OCTOBER 17, 1989

Thank you Chairman Bumpers and Senator Wallop for the opportunity to address this Committee on the efforts being made in Congress to amend the Regulatory Flexibility Act. I applaud the leadership shown by Senator Wallop and yourself in holding this hearing and raising this issue.

You may recall that I appeared before this Committee several months ago to discuss the Hazard Communication Standard and the burden that regulation imposes on small business. I also recently appeared before Senator Dixon's Subcommittee to support the re-authorization of the Paperwork Reduction Act -- which minimizes the government paperwork demanded of small businesses. Today, I am here to urge that the Regulatory Flexibility Act be amended to ensure that government agencies consider the needs and circumstances of America's small businesses and small organizations when drafting regulations.

As you know, Mr. Chairman, the Regulatory Flexibility Act requires that federal agencies engaged in rulemaking must analyze proposed rules and determine the impact of a regulation on small business and other small entities. If an Agency determines that there is no appreciable regulatory effect on small business, then the agency can "certify" that no further regulatory analysis is necessary.

If, however, a proposed rule or regulation is found to directly affect small businesses and other small entities, the agency must promulgate rules that minimize implementation and compliance costs. In short, Regulatory Flexibility simply recognizes that small businesses must be given special regulatory consideration.

The best example of the importance of the Regulatory

Flexibility Act is the way in which the Hazard Communication Standard was promulgated. The Hazard Communication Standard negatively effects thousands of small businesses. However, for a variety of reasons -- including a court challenge -- no regulatory flexibility analysis was ever completed. The resulting regulation shows how little the regulating agency, OSHA, understands the world in which the average small business must operate.

Mr. Chairman, the Regulatory Flexibility Act is an important check on government red-tape.

The Regulatory Flexibility Act recognizes that the effect of a proposed rule or regulation on small business is not always the first thing that regulators consider when drafting regulations. The problem, Mr. Chairman, is that the law requires agencies to analyze the regulatory impact of a proposed rule on small business. However, without judicial review there is nothing to ensure that federal agencies comply in good faith with the requirements and spirit of the law.

More troubling still, Mr. Chairman, is the fact that one agency in the federal government, the Internal Revenue Service, is specifically exempted from the requirements of the Regulatory Flexibility Act. Anyone who has ever owned or operated a business can tell you that IRS regulations are often the most complex, cumbersome and costly of all. Yet, by the neat trick of defining IRS rules as "interpretive", the IRS is excused from considering the cost and effect of proposed rules on small business.

The Regulatory Flexibility Act should both include the right to challenge agency no-impact certifications and bring the IRS under the Act. Mr. Ireland and I have introduced legislation, H.R. 2292 and 2293, designed to accomplish this end.

Along with our legislation, I should also mention the efforts of Representative Upton from Michigan and Senator Wallop, who have each introduced legislation that, if passed, would help achieve this goal

Before going further, I'd like to acknowledge the leading role that my good friend and colleague, Andy Ireland, has played in raising the issues of Regulatory Flexibility reform.

The legislation that Mr. Ireland and I have introduced and that of Representative Upton and Senator Wallop, can again make Regulatory Flexibility a viable tool for protecting small business. To put it bluntly, if we expect the law to work, we have to give it teeth.

The Act is too often ignored by regulatory agencies. Also, the IRS exemption means that the IRS has no affirmative obligation to appraise the impact of their "interpretive" rules on businesses in the real world.

Clearly, part of the solution to the problem is for better Congressional oversight of all federal agencies, including the IRS, and of its own actions. Congress, for example, must in the future avoid fiascos like Section 89. The resulting "interpretive" rules proposed by IRS were unbelievably complex and burdensome. However, much of the blame for that regulatory mess rests with Congress.

However, the IRS and other federal agencies should also be accountable for how well they minimize the cost of regulation. Allowing full judicial review will achieve this goal.

Specifically requiring the IRS to conduct a regulatory flexibility analysis during interpretive rulemaking will ensure that tax payers are protected from IRS regulatory excesses.

Mr. Chairman, anyone who has operated a small business, indeed, every taxpayer, knows that IRS rules are complex and time consuming. The estimated time required to comply with IRS requirements are, as often as not, vastly understated. Congress and the American people must be sure that the rules promulgated by the IRS are the most cost effective and as simple as they can possibly be.

America's small businesses are directly responsible for most of the new jobs created in this country. America's small businesses are the innovators in new technologies and services that America needs to compete in the global economy. Further, the ability to own a small business lies at the very heart of the American dream.

However, small businesses are being crippled by excessive government regulations that do not fully recognize the unique role that small businesses play in our national economy. Government bureaucrats who have never had to work in or operate a small business in the real world are often short sighted when designing regulations that effect these businesses. A strengthened Regulatory Flexibility Act will go far in protecting America's small businesses against governmental caprice.

Senator Grassley. Since you have to go soon, maybe I could ask you just a couple questions.

First, please highlight some differences between your and Mr. Ireland's bill and Senator Wallop's.

Representative Sisisky. We have two bills.

Senator Grassley. Yes.

Representative Sisisky. One just includes the Internal Revenue Service, and the other uses judicial review. I believe Senator Wallop's includes both——

Representative Upton. If I might just interject for one second, the bill which I have introduced in the House is very similar to Senator Wallop's. There are, however, two minor differences between my bill and Mr. Ireland and Mr. Sisisky's proposal.

First, the judicial review section in my bill would only allow for review of an agency's decision after the final rule is issued. It would not, in other words, allow for "interlocutory appeals." It is my understanding that H.R. 2292 would, as worded—striking the entire judicial review section of the RFA—allow for a decision of an agency to be appealed to the courts at any time during the rule making process.

I decided to limit the judicial review section to final agency decisions because it is a compromise position between what exists today—nothing—and allowing for review at any time during the rule making process (H.R. 2292). If interlocutory reviews were allowed, then it is very possible that agency regulations would be tied up in litigation forever and never be issued. By allowing for review only after the final decision by the head of the agency, this problem should not occur.

Second, I have kept the judicial review and IRS interpretive rule sections together—in one bill—rather than dividing them up into two parts, like H.R. 2992 & H.R. 2993. I think it is very important to keep these two sections together because without either section, the RFA will still be weak.

If the IRS section is changed, but judicial review is not included, then the problem with the IRS will still continue—they will just change their standard paragraph from "we do not have to do an RFA analysis because this is an interpretive rule" to "this regulation does not adversely affect small entities." The IRS will not have the incentive to follow the RFA because they will not have the threat of judicial review.

If, on the other hand, the judicial review section is changed but the IRS section stays the same, then, obviously, the problem with the IRS will still continue. Therefore, I wanted to keep these two sections together—in one bill.

Representative Sisisky. To be honest with you, we strategically split it in two bills for a reason.

Senator Grassley. OK.

Representative Ireland. But it covers the same issues.

Representative Sisisky. Right.

Senator Grassley. Should I go now to Mr. Upton?

Representative Ireland. Sounds fine.

STATEMENT OF HON. FRED UPTON, A U.S. REPRESENTATIVE FROM THE STATE OF MICHIGAN

Representative UPTON. Thank you, Mr. Chairman, and I thank you for inviting me here today to discuss the implementation of the Regulatory Flexibility Act and how this act may be strengthened to provide more effective protection for small entities, including business and local Government concerns. I will highlight my written statement for time considerations.

I am delighted to appear with both of my colleagues, Mr. Sisisky and Mr. Ireland, who have helped lead the way in their pioneer effort to push for more reforms in the Regulatory Flexibility Act.

As a Member of the House Small Business Committee, I have had the opportunity to closely examine the effect of Federal Government regulations on small entities. I have found the impact of these regulations to often be unduly burdensome, unreasonable, and very difficult to follow.

A number of my constituents have confirmed this view, and I would like to briefly share a couple of these real world examples with you from the 4th Congressional District in Michigan and explain what can be done to fix these problems.

Last spring I was contacted by a constituent from Union City, MI, an elected township official, regarding the effect of the final rule of Federal Energy Regulatory Commission, (FERC), on hydroelectric relicensing. He explained that this rule would create a serious financial burden on his village of 1,600 people. This township official went on to inform me that the village had made every attempt to comply with the requirements of FERC's rule. The engineering studies to comply with these regulations, however, have in themselves cost the village in excess of $50,000.

In this village, therefore, where the medium income is $14,500 and where 13 percent of its families are below the poverty level, the Federal Government is forcing this community to spend in excess of $50,000 on an unreasonable regulation.

As if this were not bad enough, when I researched the regulation I discovered an amazing fact. FERC certified that the rule would not have a significant economic impact on a substantial number of small entities. I guess FERC did not visit Union City in coming up with the decision. In fact, I do not think FERC visited many small cities to make this determination, because Congressman Norm Lent from New York introduced a bill in response to this rule.

Congressman Lent's bill, H.R. 1069, would exempt small communities from these burdensome regulations. Obviously, the need for this bill illustrates that FERC did not consider the effect of this rule on many small communities.

The tragedy of this story is that there is a law to protect villages such as Union City from these sorts of problems, the Regulatory Flexibility Act; however, because judicial review of agency decisions is not allowed, this law does not work as originally intended. It does not shield small entities from burdensome Federal Government regulations, and if judicial review of these decisions were allowed, then Federal agencies would, in fact, write regulations that considered the real world effect on small entities. The Regulatory

Flexibility Act should be amended, therefore, to allow for judicial review.

One final example concerning the implementation of the RFA that I will touch on is a decision that is well known to all of us made by the IRS with regard to Section 89. Certainly, this illustration will strike a familiar cord with all of us. It even came up in a town meeting just last week in Paw Paw.

The final rule issued by the IRS on Section 89 did not have to undergo a Regulatory Flexibility analysis. Because of the language of the original RFA law, agency interpretive rules are not suggested to the Regulatory Flexibility Act. Section 89 rules, therefore, without a doubt the most burdensome on small businesses this year, were not affected by the RFA. The way to remedy this situation is to simply include IRS interpretive rules within the scope of the RFA. In doing so, we will not have to worry about future Section 89s or at least overly burdensome agency rules from laws like Section 89.

In response to these problems I introduced a bill in the House along with Congressmen Ireland and Sisisky, H.R. 2260, the Regulatory Fairness Act of 1989. My bill does basically two things: It allows for judicial review; and it includes IRS interpretive rules. I believe that these two changes will put teeth in the act and will greatly aid small business people in communities across the country.

I want to thank you, Mr. Chairman, for the opportunity to appear before your Committee this morning. I hope my testimony has helped shed some light on this very important topic.

[The prepared statement of Representative Upton follows:]

STATEMENT OF CONGRESSMAN FRED UPTON

FOURTH DISTRICT OF MICHIGAN

BEFORE THE SMALL BUSINESS COMMITTEE

UNITED STATES SENATE

OCTOBER 17, 1989

Mr. Chairman, and members of the Committee, I thank you for inviting me here today to discuss the implementation of the Regulatory Flexibility Act of 1980 (RFA) and how the Act may be strengthened to provide more effective protections to "small entities," including business and local government concerns.

I am a member of the House Small Business Committee. In this assignment, I have had the opportunity to closely examine the effect of federal government regulations on small entities. I have found the impact of these regulations to often be unduly burdensome, unreasonable, and very difficult to follow. A number of my constituents have confirmed this view. I would like to briefly share a couple of these "real world" examples with you from the Fourth Congressional District of Michigan, and explain what could be done to fix these problems.

Last December I was contacted by a constituent from Niles, Michigan -- an elected township official -- who wrote to my office about the effect on small businesses of the Environmental Protection Agency's (EPA) new regulations for underground storage tanks (USTs).[1] I understand and support the need to protect our groundwater from pollution. However, as my constituent's concerns reflect, the regulations to achieve this purpose were devastating to the small-business person. The regulations ran 165 pages in the Federal Register,[2] which as you know, is not the easiest publication to read -- especially for a small-business person who is not trained in the technical jargon of these rules. My constituent's letter sums up his frustration with the EPA's regulations. He wrote: "This is only the tip of the iceberg, Fred. Local governments and small businesses need some long overdue help from Congress to get the ludicrous EPA under some sort of common sense control. The Regulatory Flexibility Act does not work for us -- please help!"

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[1] EPA Environmental Storage Tanks; Technical Requirements, 40 C.F.R. § 280 (1988)

[2] 53 Fed. Reg. 37,028 - 37247 (1988)

After receiving this correspondence, I wrote to the EPA regarding this matter. I was informed by the Assistant Administrator, J. Winston Porter, that the EPA had done a Regulatory Impact Analysis (RIA) as required by the RFA, and examined the potential impact of the rule on small entities. The EPA concluded that the rule would indeed have a significant impact on a substantial number of small entities. I applaud the EPA's efforts to perform this analysis, and to come up with the honest conclusion. However, even though this process was followed, the EPA did little to lessen the impact of these admittedly burdensome regulations on small entities.[3] Therefore, my constituent was in a lose-lose situation. Even though the EPA performed the RIA, and the conclusion was in his favor, he could not do anything to remedy his situation. Why? Because the Federal Courts have ruled that RFA analyses are not reviewable.[4] The Court held that the legislative history on this point -- whether the RFA allowed for judicial review -- was not definite. Thus, after all his effort, my constituent was still forced to follow these unreasonable regulations.

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[3] The primary relief given to small entities was to allow for a "phase in" period to help lessen the impact of this regulation.

[4] See, e.g., Lehigh Valley Farms v. Block, 640 F. Supp. 1497 (E.D. Pa. 1986).

In the late Spring I was contacted by another constituent of mine -- another township official -- regarding the effect of the Federal Energy Regulatory Commission's (FERC) final rule on Hydroelectric Relicensing.[5] He explained that this rule would create a serious financial burden on his village of 1,600 people. This township official went on to inform me that the village had made every attempt to comply with the requirements of FERC's rule. However, the engineering studies to comply with this regulation have in themselves cost the village in excess of $50,000! Therefore, in this village -- where the median income is $14,583 and where 13% of its families are below the poverty level -- the federal government is forcing this community to spend in excess of $50,000 on an unreasonable regulation. As if this weren't bad enough, when I researched this regulation, I discovered an amazing fact: FERC found that this rule would not have a significant economic impact on a substantial number of small entities. I guess FERC did not visit Union City in coming up with this decision. In fact, I don't think FERC visited many small cities to make this determination because Congressman Lent (R-NY) introduced a bill in response to this rule. Congressman Lent's bill, H.R. 1069, would exempt small communities from this burdensome regulation.[6] Obviously, the need for this bill illustrates that FERC did not consider the effect of this rule on many, or even any, small communities.

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[5] FERC Hydroelectric Relicensing Regulations, 18 C.F.R. § 4, 16 (1989)

[6] Congressman Lent's bill would exempt the licensing of any hydroelectric project located on nonnavigable waters and unimproved since August 26, 1935. This language includes most

The tragedy of this story is that there is a law to protect villages such as Union City and Niles from these sorts of problems: the Regulatory Flexibility Act. However, for reasons I already stated -- that judicial review of agency decisions is not allowed -- this law does not work as originally intended. It does not, in other words, shield small entities from burdensome federal government regulations. If judicial review of these decisions -- by the EPA and FERC -- were allowed, then these agencies would in fact write regulations that considered the real world effect on small entities. Otherwise, the agency would suffer the consequences of the law. Therefore, the Regulatory Flexibility Act should be amended to allow for judicial review.

One final example concerning the implementation of the RFA that I will touch on is a decision made by the Internal Revenue Service (IRS). Certainly, this illustration will strike a familiar cord with all of you, and is not unique to my district. The final rule issued by the IRS on Section 89 did not have to undergo a "Reg Flex" analysis. Because of the language of the original RFA law, agency "interpretive rules" are not subjected to the RFA. Therefore, Section 89 rules -- without a doubt the most burdensome on small businesses this year -- were not affected by the RFA. The way to remedy this situation is to simply include IRS interpretive rules within the scope of the RFA. In doing so,

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dams in small communities.

we won't have to worry about future Section 89s -- or at least overly burdensome agency rules from laws like Section 89.

In response to these problems, I introduced a bill in the House along with Congressman Ireland and Congressman Sisisky, H.R. 2660, the "Regulatory Fairness Act of 1989." My bill does two things: it allows for judicial review, and it includes IRS interpretive rules within the scope of the RFA. I believe that these two changes will put "teeth" into the RFA and will greatly aid small business people and small communities across our country.

A policy justification for these changes in the RFA can be illustrated through the House Small Business Committee's hearings focusing on "Europe 92." The Committee has explored ways to increase export opportunities for small businesses. I wholeheartedly support these efforts. I believe that there is much we can do to build a stronger domestic economy and compete with more vigor at the international level. However, if we want our small businesses to expand and compete internationally, as a matter of policy shouldn't we be fair to them here at home? If a small business can not understand the federal regulations that are imposed on it -- and thus spends many of its resources attempting to comply with these laws -- how can it possibly have the ability to expand into international markets?
Approving changes to the RFA like I suggested will be a step in the right direction. In doing so, we will lift many of the unreasonable rules imposed on small businesses by the federal government.

I thank you, Mr. Chairman and members of the committee, for the opportunity to discuss this important bill with you today. I hope my testimony has provided you with some helpful insights into this issue.

Senator **Grassley**. Thank you very much, Congressman Upton. Now let us go to Congressman Ireland, and then we will have questions.

STATEMENT OF HON. ANDY IRELAND, A U.S. REPRESENTATIVE FROM THE STATE OF FLORIDA

Representative **Ireland**. Thank you, Mr. Chairman. I appreciate your invitation to be here today and, as each of us has done, to express my thanks to Senator Wallop for introducing his legislation to strengthen the Regulatory Flexibility Act.

My colleague and Subcommittee Chairman, Norman Sisisky, has very ably stated the case for amendment of this critical cornerstone of small business Federal legislation, the Regulatory Flexibility Act of 1980, and Congressman Upton has reinforced that with a description of the legislation that he has introduced.

I would like to further highlight the two major weaknesses in the current law. One might ask, what is the purpose of a law if there is to be no enforcement of the law. That is the situation with which we are confronted as we review the history of the law we are discussing today.

With no judicial review, we have a law with no teeth. This is very disturbing when one considers that we wrote not one, not two, not three, but four procedures into our original legislation to allow the bureaucracy to short circuit the system when circumstances warrant it; for example, these four.

First, an agency may delay analysis in the event of an emergency.

Second, an agency may waive analysis in the event of an emergency.

Third, an agency may circumvent analysis when they determine that analysis required is also required by other laws and they would suffice.

Fourth, an agency may simply certify that a proposed rule will not have a significant economic impact on a substantial number of small entities.

As you can see, in drafting the original legislation we took great care in the development of the law to see that it is fair and equitable to all concerned. As it turned out, the process failed because we wound up with legislation not even covered by judicial review. It is time to correct that mistake.

The second problem with the law is the fact that the Internal Revenue Service for the most part is not covered. The reason for this is that the IRS issues few regulations that issue interpretive rules which are not covered by the Administrative Procedure Act. Since the IRS is not covered, we are probably exempting approximately half of the regulations and paperwork that the Federal bureaucracy creates. This is a major oversight in the law. It creates a great burden for small businesses.

We are all familiar with the recent Section 89 brouhaha, but that was only the latest of IRS regulatory nightmares. You might recall the W-4 form rewrite fiasco as well as the 1984 auto log rules.

Let me talk briefly about the 1984 auto log requirements. The IRS maintains that the contemporaneous recordkeeping requirements were a classic case of interpretive regulations. They insist that they were simply carrying out congressional orders which they were powerless to change or to control; yet, IRS used their own judgment in deciding what Congress meant by adequate contemporaneous records.

In the IRS view, this required a daily log of date, purpose, whether business or pleasure, user's name, place of use, odometer reading, and length of use if appropriate as well as other related expenses. When public pressure grew and it became obvious that reporting costs far outweighed the benefits gained, the IRS proceeded to amend their regulation and adopt tiered alternatives.

As I told the IRS Commissioner later, if the IRS had done the Regulatory Flexibility analysis that many of us thought they ought to be doing all along, they would have realized that in order to gain $150 million of revenue it would cost the taxpayers $3 billion in extra paperwork. If the IRS were under Regulatory Flexibility, this debacle would not have happened.

The IRS could, of course, voluntarily comply with the Regulatory Flexibility Act, but they will not. Usually they cite two reasons. They do not treat citizens differently, and to attempt to do so would be burdensome.

The first excuse is difficult to understand since different reporting requirements based on size are a common feature of our tax laws which include thresholds for taxes, tax reporting, and simplified forms such as 1040EZ, and so forth. Such considerations have been in place for years.

As for the agency hardship questions, the purpose of this act is to transfer the hardship of justifying regulation from small business to the Federal agency where it belongs.

Mr. Chairman, we have our work cut out for us on both of these issues. We have begun an effort in the House which includes discussion with other Members in the appropriate committees, Judiciary and Ways and Means. We applaud and encourage your similar effort here in the Senate.

Thank you, and I am ready for any and all questions.

[The prepared statement of Representative Ireland follows:]

Statement of
Representative Andy Ireland (R.-Fl)
Before the
Senate Small Business Committee
October 17, 1989

Mr. Chairman, I appreciate your invitation to be with you today and I also wish to express thanks to Senator Malcolm Wallop, for introducing his legislation to strengthen the Regulatory Flexibility Act. My colleague and Chairman, Norman Sisisky, has very ably stated the case for amendment of this critical cornerstone of small-business federal legislation - the Regulatory Flexibility Act of 1980. If I may, I would just like to further highlight the two major weaknesses of the current law.

One might ask - what is the purpose of a law if there is to be no enforcement of the law? That is the situation we are confronted with as we review the history of the law we are discussing today. With no judicial review we have a law with no teeth - one might even say the law is so weakened by this omission that it doesn't even have loose dentures. This is very disturbing when one considers that we wrote not one, not two, not three, but four procedures into our original legislation to allow the bureaucracy to short-circuit the system when circumstances warrant. For example:

- an agency may delay analysis in the event of an emergency;
- an agency may waive analysis in the event of an emergency;
- an agency may circumvent analysis when they determine that analyses required by other laws suffice; and
- an agency may simply certify that a proposed rule will not have a significant economic impact on a substantial number of small entities.

As you can see, we took great care in the development of this law to see that it was fair and equitable to all concerned. As it turned out, the process failed because we wound up with legislation not even covered by judicial review. It is time to correct that mistake.

The second major problem with the current law is the fact that the Internal Revenue Service, for the most part, is not covered. The reason for this is that the IRS issues few regulations - they issue "interpretive rules" which are not covered by the Administrative Procedures Act. Since the IRS is not covered, we are probably exempting approximately half of the regulations and paperwork that the federal bureaucracy creates. This is a major oversight in the law that creates great burdens for small business. We are all familiar with the recent Section 89 brouhaha, but that was only the latest IRS regulatory nightmare. You might recall the W-4 form rewrite fiasco as well as the 1984 auto log rules.

Let me talk briefly about the 1984 auto log requirements. The IRS maintained that the contemporaneous record-keeping requirements were a classic case of interpretive regulations. They insist they were simply carrying out Congressional orders, which they were powerless to change or control. Yet IRS used their own judgment in deciding what congress meant by "adequate contemporaneous records." In the IRS view, this required a daily log of date, purpose (whether business or pleasure), user's name, place of use, odometer readings, and length of use (if appropriate), as well as other related expenses. When public pressure grew and it became obvious that the reporting costs far outweighed the benefits gained, the IRS proceeded to amend their regulations and adopt tiered alternatives.

As I told an IRS Commissioner later, "If the IRS had done the regulatory flexibility analysis that many of us thought they ought to be doing all along, they would have realized that, in order to gain $150 million of revenue, it would cost the taxpayers $3 billion in extra paperwork! If the IRS were under Regulatory Flexibility, this debacle would not have happened."

The IRS could of course voluntarily comply with the RFA, but they will not. Usually they cite two reasons - they do not treat citizens differently and to attempt to do so would be burdensome. The first excuse is difficult to understand, since different reporting requirements based on size are a common feature of our tax laws, which include thresholds for taxes, tax reporting and simplified forms (1040

EZ, etc.). Such considerations have been in place for years. As for the agency hardship questions, the purpose of this Act is to transfer the hardship of justifying regulation from small business to the federal agency, where it belongs.

Mr. Chairman, we have our work cut out for us on both of these issues. We have begun an effort in the House which includes discussions with other Members who are on the appropriate committees - Judiciary and Ways and Means. We applaud and encourage your similar efforts here in the Senate. Thank you.

Senator **Grassley**. Thank you, Congressman.

Before we ask questions, I am going to ask Senators Pressler and Stevens for any opening statements that they may have.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator **Pressler**. Mr. Chairman, I want to congratulate the Members of Congress who are here who have done a lot of work on this.

Coming from a State that has a lot of small businessmen and small towns who must struggle with regulations, this is a very important effort.

As we are trying to compete more internationally, we need to practice free enterprise and loosen up for some of our small businessmen, because they do not have accountants, and they do not have lawyers. If every small businessman in this country could hire one more person, that would be more of a contribution than all the big factories.

My philosophy has always been to build on what we have, and I think that this effort today will help. This will be resisted by those who believe in Government intervention and believe in reports and regulations.

Our small businessmen, who do not have lawyers and accountants, and so forth, need relief. So I think this is a good step forward.

Senator **Grassley**. Senator Stevens.

STATEMENT OF HON. TED STEVENS, A U.S. SENATOR FROM THE STATE OF ALASKA

Senator **Stevens**. Mr. Chairman, I am pleased to join with you this morning. Obviously, we have a great interest in this subject matter. I thank those of you from the House who are doing so much work on it, and I am pleased to join with you.

Thank you, Mr. Chairman.

Senator **Grassley**. Chairman Sisisky was here earlier. He gave his testimony and had to go to a 10 a.m. meeting, so we have Congressmen Ireland and Upton who have given their testimony.

I have a couple of questions for Congressman Ireland.

Other than the two major issues that you have raised about judicial review and interpretive rules, are there any other oversight problems with the present law that you think we ought to be considering?

Representative **Ireland**. I guess there are a couple things. Under the law, the Chief Counsel for Advocacy has the ability to file an amicus brief in actions brought by others. In the almost 10 years that we have had the law, nothing really has been done along that line. Something, I think, in an oversight way we can pay attention to. Maybe there is some reason they have not, but that is a tool for helping the small businessman that certainly ought to be dusted off and reviewed to see why we do not get on the offense in that area.

Another thing that is kind of distressing to me and which I felt was a major part when we were working on the law when it was first passed was that there was a requirement to review over a 10-year period beginning with the passage of the law, existing regulations—in other words, the inventory of past regulations—to see how they affected small business and whether they, indeed, should be rewritten to pick up the theme of a tiered response to the needs of small business.

Very little, if anything, has taken place. In other words, if this were a banking business, the agencies would be past due on their requirement. They just have not complied with the law.

Senator GRASSLEY. On that point, do you have any thoughts about what we can do along that line?

Representative IRELAND. I guess this is the age old problem of which all of us share knowledge, and that is the stonewalling that the bureaucracy does is a part of our culture, and it takes eternal vigilance, it takes oversight on our part in Congress, it takes instilling an interest in the leadership in the various agencies, and it is going to take somebody with a big stick on both of these things in Small Business Administration to step in there and raise a little hell.

Senator GRASSLEY. Senator Pressler.

Senator PRESSLER. Is there, realistically, hope with Washington's attitude of helping out these small businessmen? There seems to be a cultural attitude. I respect small businessmen, but it seems that around these halls or within the beltway, the interests of small businesses are not protected. The bureaucracy believes that small businesses can file reports, meet regulations, and figure these complicated things out.

Is this belief in part a cultural thing that comes from inside the beltway?

Representative UPTON. I think that that is a very good question, and I think that that stems a lot of the resistance. That is another reason why we should hopefully see a bill like this get through the Congress and onto the President's desk for signature.

It is very important, as I look at the work that my two colleagues have done, Messrs. Sisisky and Ireland, who have, I think, introduced this legislation for about almost 10 years, time and time again, year after year, and we finally have a hearing. We are anxious to get some hearings on the House side.

In walking over with Mr. Sisisky today, he indicated that they had had some discussions with the Chairman of our Ways and Means Committee, Mr. Rostenkowsky, and that there might in fact be some chance that this may be included as one small part of a major bill, whether it be a reconciliation later or something like that. I think we have an outstanding chance and opportunity now, especially with your lead over here by Senator Wallop who has introduced a similar legislation, to actually see something like this get through and onto the President's desk.

Representative IRELAND. Senator, whether it "is inside the beltway" is an insightful comment, in that I think that all of us interested in small business have seen that a lot of the real thrust that is producing an understanding of the value of small business plus innovative programs that help small business are all coming from our State and local governments, for example, the export area, while our Federal Government remains moribund.

Perhaps it is a mentality inside the beltway that is beginning to change. Hopefully, it is beginning to change because I think that the rest of the country is beginning to understand what small business is all about and that it is the engine that has always driven America.

I think that behooves us with some responsibility for the bureaucracy inside the beltway to keep hammering away at things like that and get some enlightenment such as what is going on in the rest of the country.

Senator **Grassley**. Senator Stevens.

Senator **Stevens**. I have no questions.

Senator **Grassley**. Thank you, gentlemen, for coming over here to share your approach to this issue from the other body. Hopefully, we will get something passed this year and get the bureaucrats back on track.

I wonder if I could ask any of my colleagues who are going to be here for the next 15 or 20 minutes if you could chair. I am chairing because Senator Wallop cannot be here until about 10:15 a.m., and I have a HUD appropriations conference to which I have to go.

Senator, would you, please?

Senator **Burns**. I am just a junior Senator. [Laughter.]

Senator **Grassley**. I would call Counselor Swain. Otherwise, I would have to——

Senator **Burns**. Yes, we can do it.

Senator **Grassley**. Would Frank Swain, Chief Counsel for Advocacy of the Small Business Administration, come up?

Will you forgive me, Mr. Swain, because I have to go to a HUD conference committee?

Senator **Burns**. We shall be here, my friend. Are you going to leave us a flag? [Laughter.]

Senator **Grassley**. I am not sure I can trust you at all. [Laughter.]

Senator **Burns** [presiding]. Can we chair it from the corner?

Mr. Swain, thank you for coming this morning. I guess we have already submitted our statements for this. I am sorry. We had an Alternative Fuel hearing this morning, and that is kind of important to us, too. I have a hard time. I am not like Senator Stevens here. He can be in two or three places at different times, but I have not yet been able to work that.

Thank you for coming down this morning, and we are looking forward to hearing from you.

STATEMENT OF HON. FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. **Swain**. Thank you, Senator Burns and Senator Stevens. If it is all right with you, I will summarize my statement and try to make a few key points and leave the Committee plenty of time for the other witnesses who are genuine small business people and have important comments on the law.

Mr. Chairman, the Regulatory Flexibility Act was passed in 1980. For the past 9 years it has been the handle that small businesses have been able to encourage Government agencies to make different, and in many cases more flexible, decisions when they go about their missions of protecting the environment or the workplace or collecting the taxes or whatever.

The Regulatory Flexibility Act recognizes that in meeting those important governmental missions, agencies have a high potential for throwing big curves at small business. The Regulatory Flexibility Act attempts to set out a procedure within the context of the Administrative Procedure Act that requires agencies, before they issue a regulation that will have a significant economic impact on a substantial number of small businesses, to make some special findings as to what that impact is and to make some special findings as to how they may alter their regulations to make them less burdensome for small business.

The reason for this is obvious, I think, to most people who are interested in small business. However, we sometimes have trouble convincing agencies that it costs more for a small business to comply with the same regulation than it costs for large business.

Regulatory costs tend to be fairly fixed, if you have to hire a new lawyer or you have to buy a new machine or whatever the case may be; that cost can be the same whether you have 10 employees or 1,000 employees. Therefore, the actual cost on a per unit basis or a per worker basis are far higher for small businesses.

I am sure that you Senators hear every day from businessmen and businesswomen in your districts who are complaining not about regulations and whether they should be in place but about the cost and inconvenience of those regulations.

As a result of this, the Congress in 1980 passed the Regulatory Flexibility Act. Under the act, agencies must assess what the impact of the rule would be on small business, to prepare an analysis which contains the reasons why the action is being taken, a succinct statement of the objectives and the legal basis for the action, a description and the estimate of the number of small businesses affected by the action, a description of the reporting and recordkeeping requirements, and, finally, any duplicative Federal regulations.

It seems all fairly common sensible, but I can tell you that there are a number of regulations that are issued every week of the year in which agencies do not pay a lot of attention to those factors that I laid out above.

There is a mixed record on agency compliance with the Regulatory Flexibility Act. There are many instances of agencies using the RFA to improve their rulemaking process. For example, the Department of Labor made some major, important changes in the Davis-Bacon Act regulations several years ago. Those changes, I think, were accompanied and assisted by a very good Regulatory Flexibility Act analysis. Likewise, the Environmental Protection Agency regularly performs Regulatory Flexibility analysis to investigate the impact that their rules will have on small business.

Other agencies use the RFA process to solicit comments on the effect of their proposals on small business, including the Securities and Exchange Commission, the Federal Trade Commission and several others.

Unfortunately, there are some agencies that view the Regulatory Flexibility Act as simply another procedural impediment to the promulgation of a particular rule. I must say that probably the worst offender from the prospective of the small business community is the Internal Revenue Service. The IRS has a lot of important functions in the Government to protect the revenue and interpret the complicated tax laws that have been regularly passed by the Congress but in the context of so doing they do not seem to pay as much attention as they should to the impact of their decisions on small firms.

The legislation that the Committee is looking at this morning basically does three things to change the law. First, and I think of broad importance to the small business community, it would extend the scope of the Regulatory Flexibility Act to what are called interpretative rules by the Internal Revenue Service.

As the three Congressmen each have very ably said, because of the way the IRS issues most of its key decisions now RFA analyses are not required under the law that Congress passed in 1980. The small business community simply feels that that requirement should be extended to the bulk of what the Internal Revenue Service does, including the interpretative rules that they have promulgated recently on such issues as Section 89, auto logs, and the COBRA law that was passed in 1985 which I have explained in my statement.

All of these and many, many more decisions made by the Internal Revenue Service have a very broad impact on the small business community, and I believe that the Internal Revenue Service should be under an affirmative obligation to lay out to the small business community their assessment of the impact of their proposal.

Small business people are not by and large technical tax experts. It is very difficult to wade through a lot of the requirements that the IRS issues, necessarily so because the tax laws are complicated. Nonetheless, the Internal Revenue Service needs to do a better job, and apparently the best way to get them to do a better job is to pass a law that would require it.

The second issue that the proposed legislation addresses is the issue of so-called indirect impact. In many cases, an agency will issue a regulation which they say only affects large business; therefore, does not have to be analyzed for small business impact. However, the indirect impact is in many, if not most, cases of economic regulation largely on the small business community. Not all, but some, agencies seem to hide behind that distinction.

I will give you an interesting current example. We just commented to the Federal Trade Commission yesterday on an issue involving labeling requirements for smokeless tobacco. You may know that Congress 3 years ago passed a law that said that smokeless tobacco products shall have health warnings just as cigarette and other tobacco products have. The FTC is currently issuing those rules.

The FTC says all the companies that produce smokeless tobacco are large companies, and I suppose that is true. We have no reason to question that. In fact, however, most smokeless tobacco promotion or a lot of it is preferred to small businessmen who produce utilitarian items, such as hats, T-shirts, and golf tees. The question then becomes how does one take a hat that has the logo of a tobacco company on it and add the required warning? How does the advertiser let the public know that the tobacco company on the label or the front of the hat might be putting out a product that is hazardous to your health?

It is a legitimate question; it is a regulatory question that the FTC has to solve.

The FTC at this juncture has said we are only going to take a look at the impact of this on big business because these smokeless tobacco producers are big businesses. We are not going to do a Regulatory Flexibility analysis because there are no big businesses affected.

The impact of the decision, though, is going to be on all the little companies that are in the specialty advertising field that make the hats, the T-shirts, the matchbooks, the golf tees and everything else.

I am not saying there should not be warnings or that they should not be displayed properly or appropriately. I am just saying that this particular Regulatory Flexibility process does not seem to apply very well in this particular instance because of the indirect effect issue, and I think that some legislation could clear that up.

Senator **STEVENS**. Are you saying you would hold up the FTC action with regard to complying with the existing law as it applies to the manufacturers until we find out how the decision might affect the advertising through small business?

Mr. **SWAIN**. Not quite, Senator. What I am suggesting is that the FTC will be able to make a rule that is more effective if they take the time to take a look at how the advertising industry, which is primarily small business, can respond to the rule.

I am not suggesting at all that the rule be held up. We did file comments with the Agency yesterday, and our comments were to the point that the Agency ought to, in the process of going ahead to take special pains to visit with the small businesses affected by the rule and figure out what their costs will be and the various options that there might be for enforcing the rule.

My only point is that the FTC, I suspect, will go ahead and voluntarily do this, but the law does not require them to do so. We have had some other instances where agencies have simply refused or declined to look at small business because the law does not require it.

The third point is one that was also mentioned by the previous congressional witnesses; that is, the real problem with agency compliance with the Regulatory Flexibility Act is when it does not occur. When it does occur, it is a big help, but when it does not occur there is really very little that can be done.

The small business community cannot take an agency to court and say that the rule is invalid because they failed to comply with the Regulatory Flexibility Act. That is why we do feel that part of the original law involving judicial review should be changed to make it clear that there are court actions that may be effective against agencies when there is a refusal to comply with the Regulatory Flexibility Act.

Mr. Chairman, the Office of Advocacy at the SBA probably spends more time on reviewing regulations, working with agencies to make better regulations for small business and improving regulatory review and the regulatory process than any other single assignment that has been given to the office.

We think that there has been a lot of progress. We think that there are several things necessary for continued success: Strong political leadership in the Administration; continuing strong oversight by congressional committees and by the Congress; a small business community that is interested in a regulatory process and willing to make its voice heard; and a very strong law.

I hope that the Congress will act to make this law stronger and more effective for small business. Thank you.

[The prepared statement of Mr. Swain follows:]

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WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

TESTIMONY OF

HONORABLE FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

UNITED STATES SMALL BUSINESS ADMINISTRATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

OF THE

UNITED STATES SENATE

OCTOBER 17, 1989

AMENDMENTS TO THE REGULATORY FLEXIBILITY ACT

- The Regulatory Flexibility Act (RFA) is an important tool in ensuring that federal agency rules meet the standards of reasonableness mandated by the Administrative Procedure Act. At the same time, the RFA protects the viability of small businesses by ensuring that the federal agencies analyze the impact of their rules on small businesses and examine ways to the mitigate any adverse impacts.

- The failure of the Internal Revenue Service to examine its rules under RFA, the lack of analysis of indirect effect of rules, and the uncertainty surrounding review of certification decisions weaken the effectiveness of the RFA.

- S. 1458 would correct these defects by requiring the Internal Revenue Service to review its rules under the RFA, would mandate agency consideration of the indirect effects of its rules, and increase the opportunity for judicial review of certification decisions. We fully support these amendments to the RFA and believe they will enhance the RFA's role in the reasoned decisionmaking process called for by the Administrative Procedure Act.

Good morning Mr. Chairman: It is a pleasure to appear before the Small Business Committee. The issue before the Committee this morning -- amending the Regulatory Flexibility Act -- is a subject of paramount interest to me. At the outset, the views presented in my testimony are my own and are not the final opinion of the Administration.

This is not the first time that the Regulatory Flexibility Act (RFA) has been explored by your committee. However, this is the first time in which amendments to the Act are examined in depth. I come to this Committee with a unique perspective on the RFA. As the official charged with monitoring agency compliance since 1981, I have dealt with agency compliance, attempts to comply, and outright noncompliance since almost the inception of the act. Without the changes proposed in S. 1458, the RFA will not achieve the kind of change the authors originally intended -- federal agency recognition of the effects that their rules will have on small businesses and responsible modification of these rules to lessening the burden on small business.

I. The Regulatory Flexibility Act

Before discussing the problems in applying the RFA, a brief review of the Act and what it requires of federal agencies is necessary.

The Administrative Procedure Act (APA) requires federal agencies to promulgate rational rules. The APA provides the primary mechanism for accomplishing this task -- notice and comment rulemaking. The RFA is another management tool to improve the ability of federal agencies to comply with the APA's mandate for reasoned decisionmaking. The RFA is based on two premises: 1) that federal agencies often do not recognize the impact that their rules will have on small businesses; and 2) that small entities are disproportionately disadvantaged by federal regulation compared to their larger counterparts.

If the cost of compliance with a federal regulation is fixed, then the smaller firm will suffer a more severe impact since it has a smaller output over which to recover the costs. An example might be illustrative. Widget manufacturer A produces 100 widgets at a cost of a dollar a widget for a total production cost of 100 dollars. Widget manufacturer B also produces widgets at the same price but only produces 50 widgets. If a government regulation imposes an added fixed cost of 10 dollars, then the cost of production for each widget for the smaller manufacturer goes to $1.20 while the cost of production for each widget to the larger manufacturer is only $1.10. As a result of the government regulation, the larger widget manufacturer can undersell the smaller manufacturer and still make a profit. This example highlights the existence of scale economies in compliance with federal regulations. A study commissioned by the Office of Advocacy,[1] confirmed that scale economies exist in complying with a diverse variety of federal regulations. While I used manufacturing as an illustration, the study examined such diverse areas ranging from aluminum effluent guidelines to truth-in-lending regulations. In each case, the study revealed that larger firms can comply with various types of government regulation at a lower cost than small businesses.

The RFA was enacted to obtain federal agency recognition of these effects and take steps to reduce them. By mitigating the impact of government regulation on small businesses, the viability of small businesses will be determined in the marketplace not a federal office. Of course, the real world is never as simple as widget manufacturing, and the direct effects of a proposed rule may not be obvious. Nevertheless, the RFA requires federal agencies to assess the impact of their proposals on small businesses. Agencies then have two options under the statute -- performing a regulatory flexibility analysis or issuing a certification.

An agency certifies a rule if it determines that the rule will not have a significant economic impact on a substantial number of small entities. Announcement of the certification is required in the FEDERAL REGISTER and the certification must be accompanied by "a succinct statement explaining the reasons for such certification...." 5 U.S.C. § 605(b) (1982).

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[1] JACK FAUCETT ASSOCIATES, ECONOMIES OF SCALE IN REGULATORY COMPLIANCE: EVIDENCE OF THE DIFFERENTIAL IMPACTS OF REGULATION BY FIRM SIZE (1984) (Contract SBA-7188-OA-83).

An agency assessment which reveals that the rule will have a significant economic impact on a substantial number of small businesses requires the agency to prepare a regulatory flexibility analysis. The analysis must contain: 1) the reasons why the action is being taken; 2) a succinct statement of the objectives and legal basis for the action; 3) a description and estimate of the small businesses affected by the agency action; 4) a description of the reporting, recordkeeping, and other compliance requirements with special attention to the affected small businesses; and 5) any duplicative federal regulations.

Most importantly, the regulatory flexibility analysis must describe and analyze any significant alternatives to the agency action which accomplish the objectives of the rule and its underlying statutory authority but minimize the economic impact on small businesses. Significant alternatives may include: 1) establishment of diverse compliance or reporting requirements that take into account the resources available to small businesses; 2) performance rather than design standards; or 3) exemptions of small businesses from all or part of the rule. In the final analysis, agencies must give reasons why they did not adopt the alternatives which were presented to the agency during the rulemaking process.

Both the regulatory flexibility analysis and certification are designed to force federal agencies to articulate the effects of proposed rules on small businesses. This process should be viewed, not in isolation, but rather as an important component of the administrative process. Thus, the RFA only provides a means to an end already dictated by Congress in the APA -- reasoned agency rulemaking.

II. Agency Compliance with the RFA

Without reiterating the entire history of RFA compliance, a brief synthesis will serve to highlight the successes and problems of the RFA. Agency compliance with the RFA runs the gamut from near total compliance to near total disregard for this Act.

To come before this committee with a litany of compliance problems would not tell the entire RFA story. There are many instances of agencies using the RFA to improve their rulemaking process or garner more support for their regulatory actions. For example, the Department of Labor used a regulatory flexibility analysis to support modification to the rules implementing the Davis-Bacon Act. The Environmental Protection Agency regularly performs regulatory flexibility analyses to investigate the impact that their rules will have on small business. These analyses often lead to modification of the rules to lessen the impact on small businesses. Other agencies use the RFA process to solicit comments on the effect of their proposals on small businesses. The Securities and Exchange Commission noted that its modification to the small offerings rule would be beneficial to small businesses. The Federal Trade Commission regularly requests comments on its initial regulatory flexibility analyses and certifications in order to assess the impact of rules on small businesses. These are only a few of the success stories of the RFA. A review of my annual reports to Congress will reveal other rules that have been improved as a result of the process mandated in the RFA. The RFA generally has proven effective in integrating the assessment of small business impacts into the agency decisionmaking process. In turn, this leads to the ultimate goal of rational rulemaking mandated by the APA.

Unfortunately for each success story there are also numerous failures. These failures often may lead to the imposition of unduly burdensome requirements on small businesses thereby threatening their viability. Some agencies view the RFA as another procedural impediment to the promulgation of a particular rule. Rather than using the RFA as an integral part of rulemaking, agencies often issue perfunctory certifications without performing the underlying assessment of small business impacts necessitated by the RFA. Other agencies have not been able to reconcile their statutory mandate with the strictures of the RFA. Some agencies, do not comply with the analytical requirements in the RFA by using loopholes or weaknesses in the RFA to avoid compliance with the analytical requirements of the Act.

Removal of these loopholes coupled with greater opportunity to obtain judicial scrutiny should promote better compliance with the RFA and, ultimately, improve agency rulemaking. S. 1458 addresses the RFA compliance problems engendered by interpretative rules of the Internal Revenue Service and the failure of the RFA to require analysis of indirect effects on small businesses not directly regulated by a rule. Finally, the bill would remove the uncertainty surrounding inclusion of certifications as part of the administrative record on judicial review.

III. Problems with the Regulatory Flexibility Act

A. Interpretative Rules

The RFA currently requires federal agencies to comply with the Act only when they are required to issue notice and comment rulemaking under the Administrative Procedure Act (APA) or some other law. 5 U.S.C. § 603-05. Thus, interpretative rules, general statements of policy, and rules concerning loans, grants, benefits, or public contracts are not subject to the analytical requirements under the act. For the most part, this causes no problems in agency compliance with the RFA. Rules which are most often classified as interpretative do not pose problems for small businesses as a general rule. Similarly, rules concerning agency management, while significant, usually do not affect small businesses. One exception to this is the actions taken by the Internal Revenue Service (IRS).

The vast majority of rules issued by the IRS are denominated by the Service as "interpretative."[2] These rules are issued to advise the public of the Service's construction of the tax laws. Many rules which the IRS labels "interpretative" are indistinguishable from legislative rules, i.e., those rules requiring notice and comment, in their substance and effect. To the small business owner, who must comply with the Service's rules, they are one and the same.

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[2] The chief distinction between these rules and rules subject to notice and comment under the APA is that these rules do not have the force and effect of law. Thus, individuals can take actions at variance with the interpretative rule recognizing that the action may be viewed by the Service as violative of the tax laws. *Cf.* American Medical Association v. Heckler, 606 F. Supp. 1422 (S.D. Ind. 1985) (violation of HHS interpretive rule viewed by agency as violation of statute but such view does not convert rule into substantive rule requiring notice and comment). Such actions will eventually be tested in litigation in which the court can substitute its own interpretation of the statute for that of the agency's. *See, e.g.*, Doe v. Revitz, 830 F.2d 1441 (7th Cir. 1987).

Interpretative rules can and often do have a substantial impact on the individuals or businesses subject to the rules. This is especially true in the case of interpretative rules issued by the IRS. They can affect every small business in the country. Yet, most small businesses have neither the financial or legal wherewithal to challenge such issuances in court. As between complying with the Service's interpretation of a provision of the tax code or challenging it in court, a small business will invariably follow the Service's interpretation even if the impact on the business is severe.

The Office of Advocacy, as well as Congressional committees with RFA oversight responsibilities, have repeatedly urged the IRS to put aside the often arbitrary distinctions drawn between interpretative and legislative rules and utilize the analytical procedures of the RFA to provide a solid foundation for its rulemakings. However, after sweeping changes in the tax code and passage of the Taxpayer Bill of Rights, the IRS is still not in compliance with the RFA.

The IRS views most regulations as interpretative. Accordingly, even though these rules are normally published for notice and comment, they technically fall outside the scope of the RFA. The Service has used this exemption and has otherwise avoided the small business analysis required by the RFA irrespective of the potential burden that the rules would place on small businesses. The RFA also does not reach Revenue Rulings, Revenue Procedures, or Notices. These are akin to general statements of policy which are not subject to notice and comment rulemaking and thus exempt from the analytical requirements of the RFA. Although the various subcategories of IRS pronouncements do not have the same legal weight as a legislative regulation, as a practical matter, they are relied upon by the regulated community. The IRS decision to classify a rule or pronouncement in a particular manner is virtually unchallengeable in court.

Perhaps the best example of a recent "interpretative" regulation which has had a negative impact on small business is Proposed Regulation § 1.1162-26, which concerns the continuation coverage requirements of the Consolidated Budget Reconciliation Act of 1985 (COBRA). The continuation coverage requirements seek to ensure wider access to employer-sponsored health care by requiring employers with group health plans to continue to offer similar coverage upon their employees' separation from work or upon a reduction in their hours. Although the IRS maintained that the discretion to interpret COBRA or to fashion sanctions was limited, the penalties contained in the proposed regulation were more stringent than those required by statute.

The Office of Advocacy criticized the proposed regulation for serving as a barrier to the adoption or expansion small business health plans and offered several alternatives to the method of applying the sanctions in order to minimize the burden on small business and better fulfill the intent of the legislation. The proposed COBRA regulation generated well over 1,300 comment letters. This is an example of when the rulemaking would have benefitted from the requirements of the RFA. A regulatory flexibility analysis would have provided valuable information to both the small business community and the IRS, and helped to resolve many of the issues covered by the regulations. Neither the IRS, the small business community nor anyone else was well-served by the RFA's failure to reach such rules. Notwithstanding the extensive public comments received and the hearings that were held, the IRS did not make any modifications to lessen the impact on small businesses. Ultimately, Congress reformed the law in the 1987 Omnibus Reconciliation Act.

I believe the Service's activities need the sunshine provided by the RFA. The IRS has a difficult task and for the most part does an exceptional job in interpreting and enforcing the constantly revised tax code. However, its interpretations have substantial impact on small businesses and the agency should consider these effects when it issues rules. The Service may find that there are less onerous alternatives on small businesses which do not detract from its primary mission of collecting taxes.[3] I personally support the modification in S. 1458 which would require the Service to comply with the RFA. However, I would suggest that the bill be amended to limit RFA analysis to those rules which interpret the tax code and not any rule issued by the Service which may include rules concerning personnel and the like. Small businesses would best be served by incorporating within the legislation the Service's announcements which have a direct impact on small business.

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[3] The provisions of the Taxpayer Bill of Rights do not provide a satisfactory solution to the problem. In reality, all the IRS need do is send a copy of the FEDERAL REGISTER notice to the Small Business Administrator. Nothing guarantees that the Service will assess the impact of interpretative rules on small businesses.

B. Indirect Effects

Agency rules have both direct and indirect effects. Direct effects of rules are those that impose some type of cost on a business covered by the regulation. Indirect effects are those which may have an impact on a business but not the one covered by the regulation. Let me return to the widget manufacturer to explain. Assume that a federal agency passes a rule requiring widget manufacturers to install a device to protect its workers and would cost the widget manufacturer tend dollars. This cost is considered a direct effect of the regulation. Now assume that a federal agency adopts a regulation imposes costs on steel companies. Widget makers, as users of steel, will be affected by any cost increase to steel manufacturers. The rule affects the widget industry even though the rule only applies to steel plants. This is an indirect effect.

No doubt exists that direct effects of federal rules are subject to analysis under the RFA. However, some doubt exists concerning the need to analyze indirect effects of rules. The legislative history of the RFA on this subject is somewhat ambiguous. One of the main sponsors of the legislation, Senator Culver, stated that both direct and indirect effects of rules must be analyzed. 126

CONG. REC. 21,558-59 (1980).

An electric cooperative used this legislative history as part of a challenge to a Federal Energy Regulatory Commission rules which would allow utilities to include construction expenses in their rate base. The Commission certified that the rule would not have a significant economic impact on a substantial number of small entities because the rule only applies to large public utilities. The cooperative argued that the rule would raise the rates to small business customers and the Commission should have considered the indirect effect of the rule.

The D.C. Circuit resolved the dispute over the legislative history in *Mid-Tex Electric Cooperative, Inc. v. FERC*, 773 F.2d 327 (D.C. Cir. 1985). The court held that the statements of Senator Culver and others were ambiguous. The court suggested that the indirect effects applied only to the indirect effects on the industry actually affected by the rule. Thus, the court's opinion, in practical terms, only required agencies to assess the impacts on small businesses if small businesses are regulated by the proposed or final rule.

The *Mid-Tex* decision can be used by federal agencies to restrict the scope of their analysis on rules which may have a significant impact on the cost of doing business. Agencies like the Environmental Protection Agency which impose rules on manufacturers affect the users of those goods. Yet, *Mid-Tex* provides the agency with a solid legal basis to avoid assessing the real impact of its rules. Other agencies like the FERC or the Federal Communications Commission regulate utilities, and any decision increasing the cost to utilities are often passed directly on to the customers. The competitive difficulties engendered by these decisions are further exacerbated by the ability of large competitors to bypass public utilities and generate their own electricity or establish private telecommunication networks. For these reasons, I support the modification to the RFA in S. 1458, which would mandate consideration of direct and indirect effects of an agency rule on small businesses.

IV. Judicial Review

The inclusion of the Internal Revenue Service rules and the mandate to examine the indirect effect of rules will go a long way to correcting many of the implementation problems I have found since the passage of the RFA. However, more is needed. Imposition of more analytical requirements is a necessary but insufficient condition to force agencies to assess and deal with the impacts that their actions have on small businesses. The initial decision to certify a rule is a threshold question that triggers any further analysis by an agency. By simply certifying that the rules does not significantly affect a substantial number of small entities, an agency can avoid any analysis of the impacts on small businesses. Absent some procedure to force agency compliance with the RFA, such as improved opportunity for judicial review of certification decisions, some agencies will continue to evade the spirit of the RFA through mechanical and boilerplate application of the certification provision.

Section 611 provides that compliance or non-compliance with provisions of the RFA by a federal agency are not subject to judicial review. However, any regulatory flexibility analysis shall constitute part of the record for review by a court. Thus, any challenge to the ultimate reasonableness of a rule shall include consideration of any regulatory flexibility analysis performed for the development of the federal rule. The court could then determine that a defective regulatory flexibility analysis could lead an agency to underestimate the harm to small business and this harm could be sufficiently significant to undermine the reasonableness of an otherwise reasonable rule. The rule would be set aside:

> not because the regulatory flexibility analysis was defective, but because the mistaken premise reflected in the ... analysis deprives the rule of its required rational support, and thus causes it to violate -- not any special obligation of the Regulatory Flexibility Act -- but the general legal requirement of reasoned,

nonarbitrary decisionmaking....

Thompson v. Clark, 741 F.2d 401, 405 (D.C. Cir. 1984).

Conspicuously absent from section 611 is any mention of a certification issued pursuant to section 605. Federal agencies could avoid any review of the impact of their rules on small business by simply certifying that they do not significantly affect a substantial number of small entities.

This situation is set in stark relief in *Lehigh Valley Farms v. Block*, 640 F. Supp. 1497 (E.D. Pa. 1986), *aff'd*, 829 F.2d 409 (3d Cir. 1987). There a group of dairy producers challenged the Agriculture Department's decision to expand a milk marketing order to counties not already included in the order. The plaintiffs asserted, inter alia, that the Secretary's decision failed to comply with the requirements of the RFA. The Secretary had determined that the changes in the marketing order would not have a significant impact on a substantial number of small entities. The plaintiffs contended that USDA's certification of no substantial small business impact was incorrect. The court agreed, but recognized that the threshold issue was whether the court could review the Secretary's decision to certify.

The court agreed, albeit reluctantly, with the D.C. Circuit's holding in *Thompson v. Clark*. There the court held that a decision by the Secretary of Interior to certify a proposed rule a determination by the agency of the applicability of the RFA and therefore not subject to review under section 611. 741 F.2d at 405. The *Lehigh Valley* court noted that Senator Culver's statements concerning review of certifications appear contradictory. At one point the Senator stated:

> If an agency ... completely and consciously ignores the ... requirement to perform regulatory flexibility analyses, an injured party would have grounds to argue that this fact is evidence of the unreasonableness of the rule....

126 CONG. REC. S 21,457 (daily ed., August 6, 1980). Yet the Senator also reiterated that "the decision regarding when the agency shall conduct a regulatory flexibility analysis remains in the sole discretion of the agency." 126 CONG. REC. 21,460-61 (1980).

The initial decision to certify a rule is a threshold question that triggers any further analysis by an agency. Without an adequate means to challenge this initial assessment of the impact of a rule on small businesses, agencies can ignore the intent of the RFA -- to consider and mitigate adverse impacts on small businesses. The absence of meaningful judicial review of certifications has created a checkered compliance record dependent upon each agency's essentially voluntary commitment to sound decisionmaking processes. In turn, this undermines the rational decisionmaking process mandated by the APA.

Since the passage of the RFA in 1980, 24 states have adopted legislation addressing the same problems and goals as the federal Regulatory Flexibility Act. One of those states, Washington, adopted a comprehensive law in 1982 which, like the federal act, precluded judicial review. They amended their act this year because they found it to be ineffectual because there was no judicial review provision. The new law went into effect on July, 1 and agencies have already demonstrated a more serious commitment to conduct small business regulatory analyses and adopt less burdensome regulations.

I believe that the modification in S. 1458, specifying that certification decisions are to be part of the record upon review is a step in the right direction. The proposed amendment to the RFA would do for certification decisions what the court interpretation currently permit for regulatory flexibility analyses. An agency decision based on the mistaken premise reflected in the certification might well deprive the rule of its reasonableness and cause a court to find that the rule violates the Administrative Procedure Act.

V. Conclusion

The amendments to the RFA proposed in S. 1458 should significantly improve compliance with the RFA. The amendments should not be viewed as constructing new barriers to agency rulemakers; rather they should be viewed as enhancing the effectiveness of the RFA. A more effective RFA will help ensure that federal agencies meet the APA's mandate of reasoned decisionmaking. Any amendments designed to improve agency decisionmaking must seriously be considered by Congress. I fully support Senator Wallop's bill and would be willing to work with the committee to ensure its passage.

I would be happy to answer any questions from the Committee.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

November 24, 1989

Honorable Malcolm Wallop
United States Senate
237 Russell Senate Office Building
Washington, D.C. 20510-5001

Dear Senator Wallop:

Enclosed are the responses to the questions you asked pursuant to the hearing held on your bill amending the Regulatory Flexibility Act by the Senate Small Business Committee on October 17th. The legislation you introduced is important for small business and would make several changes that would improve federal rulemaking.

It has been a pleasure working with you and the Small Business Committee on this issue.

The Office of Advocacy will be happy to respond to any further questions you may have.

Very truly yours,

Frank S. Swain
Chief Counsel for Advocacy

Enclosure

cc: Honorable Dale Bumpers

1. Can you respond to Mr. Ireland's comment about the lack of utilization of the amicus brief section of the law?

Section 612(b) of the Act authorizes the Chief Counsel to appear as amicus curiae in any judicial review of an agency rule in order to present views on the effect of the rule on small entities. Subsection (c) mandates that courts grant any application made by the Chief Counsel to appear in court.

The amicus provision comes into play only when a rule is challenged in court. The Regulatory Flexibility Act (RFA), as written, almost completely precludes judicial review. Therefore, there have been very few opportunities to intervene. Where RFA compliance has arisen in a case, the Advocacy office has consulted with the regulatory challengers to advise them of present our views of the RFA and the Administrative Procedure Act.

The Justice Department's Office of Legal Counsel has opined that Section 612 unconstitutionally interferes with the ability of the Attorney General to enforce the law. The Office of Advocacy disagrees with that position.

2. Can you respond to Mr. Ireland's comment about the ten year review of regulations? Do you believe most agencies will meet the ten year review requirement and if not, what actions will be taken? Will you provide agencies with an extension?

Section 610 of the RFA requires federal agencies to publish an agenda outlining their plan for reviewing all rules in effect at the time of the RFA's passage for their impact on small businesses. The agencies published the agendas within a year or two of the effective date of the Act and some have even undertaken the review of the rules. However, most agencies have not undertaken such reviews.

I do not believe most agencies will meet the ten year requirement. The RFA authorizes the agency head to certify that the agency will not meet the ten year deadline and publish such certification in the FEDERAL REGISTER. Section 610 permits the agency head to extend the deadline one year at a time for a period of up to five years. The SBA Chief Counsel does not take a role in the extension process. The RFA provides no mechanism to force agency compliance with § 610. Nor does the statute address what happens if the agencies fail to complete the review in the fifteen years since the passage of the RFA.

3. Do you believe that you have a shortage of staff members at

the Office of Advocacy? If so, and this shortage were addressed, would you utilize the amicus brief section of the law in more instances?

There is no particular shortage of staff in Advocacy. The primary reason the amicus authority has not been frequently considered is because the reviewability of Regulatory Flexibility procedure compliance is so limited in the statute itself. Were there more cases coming to count, it is conceivable that the Office of Advocacy might regularly be considering whether filing as an amicus would be helpful or important to the regulatory outcome. In that situation, then the staff resources necessary to complete an amicus filing would certainly be a factor the Chief Counsel would consider. But it should only be a secondary factor. The primary factors would involve a consultation as to whether the Advocacy amicus would be uniquely informative to the proceeding, or whether the proceeding is of great importance or significance to the small business community.

4. Short of judicial review, could you use the amicus brief in more cases, or do you believe judicial review is the only thing that will realistically provide for better enforcement of the RFA?

The utility of the amicus provision of the RFA is quite limited without amendments to the RFA. An amicus brief can offer arguments to show that an agency's certification that a proposed rule will not have a significant economic impact on a substantial number of small entities was incorrect, but such arguments will be of little value if the court determines that the certification decision is left to the discretion of the agency and unreviewable by the court. Judicial review of reflex decisions will result in better compliance. And if there is a legislative change providing for more judicial review, there will be more cases in which the amicus might be helpful.

5. If interpretative rules were covered under the Act, would the Office of Advocacy require a larger staff of tax attorneys to review those proposed rules, or do you perform that task now as a general rule in order to suggest changes which you think might be helpful?

The Office of Advocacy currently reviews the proposed rules of the IRS but, as you know, no small business analysis included with the proposals. If the IRS were to engage in meaningful regulatory analyses which put forth clear reasons for their actions, our current staff level may well be adequate. The Advocacy staff currently attempts to assess the small business impact of major IRS decisions. With more analysis by the IRS, Advocacy's job might actually be simpler, and not more complicated.

6. Quite a few agencies such as OSHA and EPA have small business ombudsmen. Are these agencies more effective in tailoring their regulations to small business concerns and if so would other agencies such as the IRS be more aware of small business concerns if they had an ombudsman?

The EPA's success with the RFA stems from an agencywide recognition that the analysis required by the RFA will improve agency decisionmaking and provide greater support for the EPA in any subsequent court challenges to their rules. The EPA ombudsman has frequently played an important part in reminding senior officials of that sensitivity to small business.

On the other hand, OSHA does not place such a high priority on small business impacts. For example, the hazard communication standard, as currently promulgated by the OSHA, imposes significant adverse economic impacts on a substantial number of small entities. The presence of a small business ombudsman did little to alleviate the effects of the standard. Thus, the presence of a small business provides does not insure that an agency will recognize the effect of its action on small businesses and take measures to ameliorate any adverse impacts.

I would not want to predict whether establishment of a small business ombudsman within the IRS would have any effect on the Service's regulation writers. However, a statutory mandate requiring compliance with the RFA, coupled with effective judicial review, would significantly alter the IRS's regulatory perspective. The agencies that fail to recognize the effect of their actions on small businesses do not need more personnel; rather they need some mechanism to change their institutional perspective. Amendments to the RFA to require agencies to examine the indirect effect of their rules, to require certain regulatory agencies to perform RFA's even though the regulated entities are dominant in their field, and providing greater opportunity for judicial review of certification decisions will be far more effective in obtaining agency recognition of small business concerns than the creation of another office in each federal agency.

7. Earlier this year, I introduced legislation to require an economic impact statement on all bills providing new employee benefits. Do you agree that if such a provision was adopted it would assist the regulatory agencies in complying with the Regulatory Flexibility Act, particularly if it were applied to all legislation across the board?

The more information available to an agency on the effect of government actions, legislative or regulatory, on small businesses will be beneficial. Information contained in the legislative analysis would give agencies a starting point at which to start their own analyses. In addition, the analysis would help small businesses and the Office of Advocacy determine whether the main effect of the agency action is a result of the legislation or the agency's method for implementing the statute. For example, if the impact statement found that the legislation would impose costs in the range of ten to twenty million dollars on small businesses and the agency's implementing regulations have an estimated cost of twenty million dollars, then small business could argue that the agency is proposing the most expensive method of implementing the regulations.

More importantly, the economic impact statement could provide information that Congress would use to support the establishment of different statutory schemes for large and small businesses. This distinction would then force agencies to tailor their regulations to large and small businesses. Such Congressional actions would be a significant step in ensuring agency compliance with the RFA.

8. Are there agencies other than the IRS that issue so-called interpretative rules and if so, should my legislation be expanded to include those agencies under the Act as well?

Many agencies issue interpretative rules. However, only the IRS regularly uses the interpretative rule procedure in substantive rulemaking that has a broad impact on the small business community.

9. How many rules do you review on an annual basis?

The number of rules reviewed by the Office of Advocacy will vary from year to year based on the activity of federal agencies. In 1988, the Office reviewed almost 1300 proposed rules, most of which had no impact on small businesses. The Office formally commented 58 rulemaking proceedings.

10. Which agencies are the greatest violators of the RFA as far as simple failure to do a thorough analysis or by certifying their proposed rule will not have a significant impact on small business?

It is our opinion that the Internal Revenue Service and the Agricultural Marketing Service in the Department of Agriculture, most consistently ignore the intent and requirements of the Regulatory Flexibility Act.

Senator Burns. Thank you.

I guess I have a question. You know, it seems that when Government passes a law and then we go through the process of writing administrative rules, that is an entirely different world out there which nobody has a real handle on, it always seems to me, but we are learning as we go along.

Frank, in the process where different agencies in the Government now write the administrative rules; after you go through the comment period and try to enforce those rules once they are put in place, is the Small Business Administration ever consulted? Are they told we have written these rules and now you have to handle them through small business? Are you consulted about these things before they are ever put in place or set in concrete, so to speak?

Mr. Swain. Many agencies do consult with the Small Business Administration regularly, and I think that has been a process that has been improving over the past several years.

The EPA frequently consults with the Small Business Administration because now they are in the business of writing so many rules that include small manufacturers and smaller types of businesses that they have not previously regulated.

The Federal Trade Commission and the Securities and Exchange Commission have within the last several months consulted with us on several rules.

There are agencies where the record is not as good. Within the Labor Department, for instance, the pension, benefits and welfare part of the Labor Department has consulted us quite regularly on issues relating to benefit rules.

On the other hand, we have a devil of a time getting people at OSHA to listen to us, to be candid. Mr. Sisisky referred to a current major OSHA rulemaking which is very difficult, I think, for many small businesses to understand. I think they would have done better earlier on if they had spent more time worrying about how the rule affects small business and how small businesses can comply.

The IRS is a real difficult area. Sometimes they consult with us. Sometimes they have such a backlog of tax rules that they put tax rules out and then, after they are published, we in the business community, particularly the small business community, have to tell them that the way they have originally proposed the rule just makes no sense. Maybe everybody could have been saved a lot of effort if that consultation had been earlier.

Senator Burns. I guess I am referring to a bill we have now which will address the underground storage tank through the Environmental Protection Agency that impacts a lot of us whether urban or rural. Everybody realizes that we have some problems with our underground tank storage, and nobody is complaining about the rules and regulations of getting that cleaned up.

The point is that the EPA says, well, at the same time we are going to put in the financial responsibility, which is way too high. Some operators cannot afford it, if they could get the insurance at all, and they sure cannot put up a cash bond for $1 million. Nonetheless, we are trying to address that, and that is one of those cases that I think if it was thought out before the rules were ever written, we could have avoided this thing.

I think the requirement for this rule is about 10 days away. I think it goes into effect around November 1. So we are trying to address those, and I would hope that this legislation would facilitate that a little bit better.

I have no further questions.

Senator Stevens.

Senator STEVENS. Are you in the position to say that you can support this bill on behalf of the Administration?

Mr. SWAIN. No, sir, I am afraid I am not. I am in the position of saying that personally, as a person who has had a lot to do with implementing this legislation over the last several years, based on my own experience, I support it.

I believe at this point, and my statement clearly says, that the Administration has no formal position at this point on the legislation.

Senator STEVENS. I regret that. I wish they could support it. I am concerned that we do not have enough preclearance of these items to really provide the kind of coordination that the small businesses need. I do think there is that coordination with the major businesses.

Have you ever explored the idea of sort of a one-stop clearance for small business, setting up a desk where all of the agencies would give you a few days to review proposed regulations for small businesses, a one-stop clearance?

Mr. SWAIN. Your question goes to the heart of one of the issues in the legislation.

Most agencies under the current law are required to submit to us a copy of what they propose, but we generally do not get it any earlier than the public does. We get it generally the same day or within a few days of when it is published in the Federal Register.

We do not have clearance authority in the sense that OMB has clearance. We can get back to the agency, and we can give them advice, and we can give them comment, but the SBA does not have the legal power to stop an agency from issuing a regulation.

Now in some cases we have come close to doing that because we have been able to get OMB on our side. Of course, OMB does have the legal power to stop an agency from doing something.

This proposed legislation provides that if an agency refuses to coordinate with the SBA or to do a small business analysis, a small business owner will be able to go into court and use the agency's failure in a challenge to the rule. That is not possible right now. It would take a change in law to allow that.

Senator STEVENS. I know that is the case, but it is a long way from Holicachuck to Washington, DC, and that is where they would have to do it for the small businesses in my State. I really believe we ought to find some way, if it is not preclearance at least advance notice on publication of anything that is going to impact small businesses and give you a few days to look at so that there can be some reaction.

I think this bill is a step in the right direction, but it does hire more lawyers. I have been a lawyer for a long time, but I see no reason to review regulations that should have been reviewed before they were promulgated.

I do thank you.

Senator **Burns**. Thank you, Senator Stevens.

We were just handed a note here, and I would have to concur with this. I understand that this may be Frank's last appearance before this committee or has a chance of being that?

Mr. **Swain**. Unless I die tomorrow, I believe it will be my last appearance officially as the small business advocate. [Laughter.]

Maybe I will come up here once or twice as a private citizen if I am invited.

Senator **Burns**. I will tell you. I was just looking over some stuff, and from the information I have gathered you have been with the Agency since 1980 or 1981, for the last 8 years, and you were sort of part of the Regulatory Flexibility Act and have been a very good advocate of small business. I think this Committee, this Government and this Nation owe you a little bit, because I have seen some of the work that you have done, and you have really been an advocate for small business. We want you to come back anytime you want to.

Mr. **Swain**. Thank you. I appreciate that.

Senator **Burns**. You have been a real asset to this Government and especially to the Small Business Administration, and I want to congratulate you on that and wish you the best wherever you may go.

I have no further questions, but you are always welcome. Your shadow may darken these doors any day that you want to return.

Mr. **Swain**. Thank you very much, Senator.

Senator **Burns**. I forget that I am chairing this thing up here. [Laughter.]

I saw on panel number three John Vandel from Vandel Drugs out in Torrington, WY. I am certainly happy to see that there are other drug stores in South Dakota other than Wall Drug.

We also have Dr. Glenn Cahilly, who is executive vice president of Lancaster Laboratories, Lancaster, PA; and Ms. Sally Douglas, who is assistant director of governmental relations, research and policy for the National Federation of Independent Business.

Welcome this morning. I am sort of bouncing between here and an Alternative Fuel hearing that we are having over in the Energy Department and also a Ground Transportation hearing we are having over in Commerce. So if you see me jump up and run out of here, it is not because I do not agree with you. It is because I have to be in two different places at the same time, and that gets sort of hard to do.

I would welcome a statement and welcome Mr. Vandel to Washington, DC.

STATEMENT OF JOHN H. VANDEL, VANDEL DRUGS, TORRINGTON, WY, ON BEHALF OF THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS, ACCOMPANIED BY JOHN RECTOR, VICE PRESIDENT OF GOVERNMENT AFFAIRS AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

Mr. **Vandel**. Thank you, Senator Burns. You are our neighboring State to the north, and Alaska is a little further north than that, Senator Stevens. We always keep an eye on both of you to see where the storm is coming from. [Laughter.]

Senator **Burns**. What is happening in Montana today will happen in Wyoming tomorrow.

Mr. **Vandel**. That is about right.

Senator **Burns**. Sometimes quicker.

Mr. **Vandel**. I am John Vandel from Torrington, WY. My wife, Joyce, and I own and operate a 10,000 square foot independent pharmacy in the downtown business district of Torrington, a small rural community with a population of 5,500 located in a trade area of approximately 10,000 people.

In addition to our business, I serve on the Executive Committee of the National Association of Retail Druggists.

With me today is John Rector, vice president of government affairs and general counsel.

The National Association of Retail Druggists, referred to as the NARD, represents more than 39,000 independent pharmacies where over 75,000 pharmacists dispense more than 70 percent of the Nation's prescription drugs. Together, they serve 18 million persons daily and provide 85 percent of the Medicaid pharmaceutical services.

More than 60 percent of our members are currently involved in providing home health care. NARD has long been acknowledged as the sole advocate for this vital component of the free enterprise system.

As owners, managers, and employees of independent pharmacies, we appreciate the opportunity to appear before the Committee to assist in the assessment of the Regulatory Flexibility Act (RFA), and the strengthening of this act.

Enactment of the Regulatory Flexibility Act was a top priority of independent pharmacists. Likewise, we welcome the oversight provided by this Committee since its enactment. Throughout this period we have been impressed with the monitoring activity of the SBA's Office of Chief Counsel for Advocacy, who just previously testified before this Committee.

We strongly endorse S. 1458, the Regulatory Flexibility Amendments Act of 1989, introduced by Wyoming's Senator Wallop. This coverage of so-called interpretive rules, whether actual or de facto, under RFA is essential to clarify and reinforce your original intent. Its guarantee of meaningful and judicial review of decisions that the RFA is inapplicable will breathe life into the RFA by helping to persuade the agencies to abide by the law.

Its insistence that the full impact of proposed rules and regulations, whether direct or indirect, will help assure compliance consistent with the purpose of the RFA.

Our primary insight regarding the failure of Federal agencies to comply with the RFA usually in tandem with noncompliance with other Federal laws is based upon our experiences with the Department of Health and Human Services, (HHS), in particular with the Health Care Financing Administration. Most of our experience relates to the Medicaid prescription drug program. More than 80 percent of the recipients obtain covered products and services from our members.

Three situations graphically illustrate our experience. The first relates to a more than 5 year old campaign by HCFA to confiscate the discounts that our members earn in their various relationships with the wholesaler. The second, of more recent origin, relates to the publication of drug ingredient prices for multiple source drugs since 1987. The third relates to the current implementation of the intravenous drug coverage under Medicare.

In 1984, HCFA undertook one of the most blatant anti-small business policies that we have had to confront in recent years, the confiscation of earned discounts. The HCFA effort continues today and, unfortunately, has recently been endorsed by HHS Secretary Sullivan. A central ingredient of the HCFA campaign has been to make a mockery of the Regulatory Flexibility Act.

Virtually the only subsidy support for the HCFA policy is derived from a long since repudiated 1984 study conducted by the HHS Office of the Inspector General, the OIG. Clearly, the Agency had acted without authority and failed to comply with the RFA. Eventually after congressional hearings and expression of concern by HHS, Appropriation Subcommittees and others, then Secretary Heckler ordered HCFA to stop.

Particularly important was an August 1985 opinion from the Chief Council for Advocacy advising HCFA that if it intended to confiscate the earned discounts, "The agency should institute a rulemaking in accordance with the Administrative Procedures Act and the Regulatory Flexibility Act."

Unfortunately, by the summer of 1988 HCFA was at it again. Their campaign wages on in spite of the fact that the OIG, the former HCFA Administrator and the Office of Chief Counsel for Advocacy's opinion that HCFA lacks the authority.

Extensive efforts have failed to persuade the Administration to reject this anti-small business initiative. In fact, in August 1989, HCFA, via an interpretive rule, instructed all States that they must confiscate the earned discounts.

As Senator Wallop is aware, Wyoming began participating in the Federal Medicaid Program in the summer of 1988. Since that time, for my pharmacy operations I have been keeping a financial comparison of the usual and customary reimbursement and the Medicaid reimbursement, then comparing both with the 1987 cost to dispense study commissioned by the Wyoming Department of Public Assistance and Social Services which administers the Medicaid Program in Wyoming.

The average for the past 12 months demonstrates that the usual and customary average price per prescription is 4 percent above the Wyoming break-even point determined in 1987, so this is in 1987 dollars, while the Medicaid average price per prescription is 6.5 percent below the break-even point.

If HCFA is successful in their attempt to confiscate my earned discounts achieved by prompt payment, volume buying, and other factors, my projections show that the Medicaid average price per prescription will fall to 13.7 percent below the 1987 break-even point. This would result in a loss in net profit by an amount equal to 60 percent of this past year's total net profit for all operations. I do not believe it was the intent of Congress to put this burden on my business.

You can clearly see that I and the rest of the Nation's retail pharmacists have reached the breaking point on this issue. Furthermore, I am now the only pharmacy in Goshen County that still fills Medicaid prescriptions. There were three of us; one closed, and one just refuses to fill them. If I am forced to stop, the next closest Wyoming pharmacy is 65 miles away.

For nearly 1 year HCFA has been headed by temporary managers. The HCFA Administrator's position now requires the consent of the Senate. We hope that the nomination process will prove to educate the nominee as to the importance of the Regulatory Flexibility Act, the Administrative Procedures Act, and small business in general.

It is our intention to return to the Congress next year with a proposal which will enact by law the basic terms of pharmacy reimbursement for the Medicaid Program.

Our second illustration of HCFA's failure to conduct the RFA analysis or even allow any review or comment involves the publication of price changes for multisource drugs under the Medicaid Drug Program. Twice since the Medicaid regulations became final in October 1987, HCFA has provided State Medicaid agencies with such changes: First, in June 1988, effective in July 1988; second, in April 1989, effective in June 1989. These price changes significantly affect the reimbursement for all pharmacists under Medicaid.

Again, in my own operation the effect of not being able to purchase many of the multisource drugs from our regional wholesalers at prices equal to the published Federal Financial Participation, or FFP, prices results in a decrease of an additional 4.4 percent of the drug cost component of the total aggregate of all Medicaid prescriptions. There is nothing in the regulation that would lend a reasonable person to conclude that the development and content of such list would not be subject to the APA and RFA.

Our organization on behalf of independent retail druggists have strongly protested these practices. In fact, all nine members of the Joint Commission of Pharmacy Practitioners (JCPP), have repeatedly objected to HCFA and, more recently in August 1989, to HHS Secretary Sullivan about this.

Our last example of HCFA's noncompliance with RFA and related statutes involves development of regulations to implement the intravenous drug coverage. These provisions were scheduled to take effect January 1, 1990. As of this morning, 15 months after enactment, however, the terms of reimbursement for pharmacies with less than 3 months implementation had not been published.

We have requested HHS general counsel to withdraw their recently published intravenous regulations and request the committee's assistance in helping us assure that if this benefit is retained, the letter and the spirit of APA and RFA are reflected in HCFA's action.

The charts on page 12 of our formal statement from the Senate Aging Committee illustrate the net impact of wrong HCFA Medicaid policies in recent years. The chart on the left demonstrates that the average prescription price has increased from approximately $3 in 1960 to $16 in 1988, while during this same time pharmacies' net profits have decreased from 6 percent in 1960 to slightly over 3 percent in 1988.

The chart on the right demonstrates that while the total prescription price increased from $9.17 in 1982 to $14.39 in 1987, the pharmacist's fee for the services rendered only increased from $3.04 to $3.32, or 28 cents in 6 years.

During this same timeframe, the drug product cost increased from $6.13 in 1982 to $11.07 in 1987, an increase of $4.94. So from that, I think HCFA is looking in the wrong area to get their savings.

The RFA has been a helpful tool even in working with agencies that ignore it. The provisions of S. 1458, once enacted, and vigilant oversight of the RFA will help ensure lawfulness at HCFA in the future or at least provide adequate remedies to effectively address each lawlessness at HCFA. Many private third-party prescription programs are copying HCFA-imposed reimbursement schemes so that our losses under Medicaid stand to be compounded in the private sector.

Thus, the need to assess the indirect impact of HCFA proposals under RFA is crucial to the concerns of independent pharmacies.

Lastly, we recommend that the Committee consider appropriate sanctions for conduct in violation of the Regulatory Flexibility Act. It is our intention to submit a supplemental statement with exhibits to the Committee for the record that further documents the points we have addressed.

On behalf of the officers and the executive committee and the members of the National Association of Retail Druggists, we thank you for the opportunity to continue to participate in helping to assure the full implementation of P.L. 96-354. Thank you.

[The prepared statement of Mr. Vandel follows:]

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John H. Vandel, P.D.

John H. Vandel, P.D.
Torrington, Wyoming
Executive Committee Member

A 1957 graduate of the University of Wyoming College of Pharmacy, Vandel is the owner of Vandel Drug.

He is past president of the Wyoming Pharmaceutical Association and current president of the Wyoming Board of Pharmacy, where he is serving a second six-year term. He also serves on the American Council on Pharmaceutical Education as an appointee from the National Association of Boards of Pharmacy and is president of ACPE. Vandel now serves as a member of the Eli Lilly Continuing Education Advisory Committee and the Upjohn Pharmacy Consultant Panel. He was awarded the Wyoming Bowl of Hygeia Award in 1982.

Vandel is active in his community as a member of the Chamber of Commerce and serves on the nominating committee of the United Methodist Church and on the Board of Directors of Citizens National Bank. He has been a member of the City Council, the City Planning and Zoning Board, and the County Planning Board.

Currently, he is chairman of NARD's Pharmacy Education Committee and a member of the Insurance Committee.

Statement of the National Association of Retail Druggists

REGULATORY FLEXIBILITY:
IMPACT ON SMALL BUSINESS

BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
101ST CONGRESS, 1ST SESSION
HEARING ON OCTOBER 17, 1989
WASHINGTON, D.C.

NARD
205 Daingerfield Road
Alexandria, Virginia 22314

Statement of John H. Vandel, P.D.
Before the U. S. Senate Committee on Small Business
October 17, 1989

REGULATORY FLEXIBILITY ACT: IMPACT ON SMALL BUSINESS

Mr. Chairman, Members of the Committee*:

I am John H. Vandel, of Torrington, Wyoming. I serve on the Executive Committee of the National Association of Retail Druggists. With me today is John M. Rector, our Vice President of Government Affairs and General Counsel.

The National Association of Retail Druggists (NARD) represents more than 39,000 independent pharmacies, where over 75,000 pharmacists dispense more than 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily and provide 85 percent of the Medicaid pharmaceutical services. More than 60 percent of our members are currently involved in providing home health care. NARD has long been acknowledged as the sole advocate for this vital component of the free enterprise system.

NARD members are primarily family businesses. We have roots in American's communitites. The neighborhood independent druggist typifies the reliability, stability, yet adventuresomeness, that has made our country great.

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* Senator Dale Bumpers (D-AR),Chairman
Majority: (9-D) Senators Nunn (GA), Max Baucus (MT), Carl Levin (MI), Alan J. Dixon (IL), David L. Boren (OK), Tom Harkin (IA), John F. Kerry (MA), Barbara A. Mikulski (MD), Joseph I. Leiberman (CN)
Miniortiy: (9-R) Senators Rudy Boschwitz (MN), Robert W. Kasten, Jr. (WI), Larry Pressler (SD), Malcolm Wallop (WY), Christopher Bond (MO), Charles E. Grassley (IA), Trent Lott (MS), Conrad Burns (MT), Ted Stevens (AK)

Competition in retail pharmacies is alive and well. Competition is an incentive for efficiency and the price competition in retail pharmacy is greater than can be found among the other providers of health services.

As owners, managers and employees of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair chance to compete. We appreciate the opportunity to appear before the Committee to assist in the assessment of the Regulatory Flexibility Act (RFA) and the strengthening of this Act.

RECOMMENDATIONS TO THE COMMITTEE

The enactment of the Regulatory Flexibility Act was a top priority of independent pharmacists. We supported the efforts of Senator Nelson and Senator Culver and worked with the Judiciary Committee. We were of the view then and today that P.L. 96-354, signed by President Carter, September 19, 1980, was landmark legislation. We especially welcomed the Congressional findings in Section 2(a)7 that emphasized the need for:

> "alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes may be available which minimize the significant economic impact of rules on small businesses."

Likewise, we welcome the oversight provided by this Committee since enactment. Today we reiterate our testimony to the Committee in February 1985 when we stated:

> "The Regulatory Flexibility Act should be vigorously enforced to assure that unneccessary existing rules and regulations are eliminated and that new proposals, are assessed for impact on small business, such as independent pharmacies; and appropriate action such as modification or withdrawal as was the case with the ill-conceived proposed Patient Package Insert Program. The rules and regulations of the Health Care Financing Administration are recommended as a suitable target for Committee oversight hearings. Likewise, the burdensome IRS vehicle regulations reemphasize the need to include the IRS under the Regulatory Flexibility Act."

Throughout this period we have been impressed with the monitoring activity of the SBA's Office of Chief Counsel for Advocacy. Chief Counsel Frank Swain and his staff have performed well especially given the low priority assigned by Cabinet members to small business concerns and the implementation of RFA. We were pleased to serve on their Task Force.

We strongly endorse S.1458 the Regulatory Flexibility Ammendments Act of 1989, introduced by Senator Wallop:

-It's coverage of so called interpretative rules whether actual or defacto under the RFA is essential to clarify and reinforce your original intent for P.L. 96-354;

-It's guarantee of meaningful judicial review of decisions that the RFA is inapplicable will breath life into the RFA by helping to persuade agencies to abide by the law. Compliance with the RFA through the development of bonafide reviews should result in proposed rules and regulations that, while achieving salutory public objectives are more sensitive to the operational and fiscal concerns of small business persons such as independent pharmacists.

-It's insistence that the full impact of proposed rules and regulations, whether, direct or indirect, will help assure compliance consistant with the purpose of the RFA:

> "It is the purpose of this Act to establish as a principle of regulatory issuance that agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to

> assure that such proposals are given serious consideration."

Our primary insight regarding the failure of Federal agencies to comply with the RFA, usually in tandem with noncompliance with other federal laws, is based on our experiences with the Department of Health and Human Services (HHS) in particular with the Health Care Financing Adminstration (HCFA). Most of our experience relates to the Medicaid prescription drug program. More than 80 percent of the recipients obtain covered products and services from our members.

Three situations graphically illustrate our experiences. The first relates to a more then five year old campaign by the HCFA to confiscate the discounts that our members earn in their various relationships with wholesalers; the second of more recent origin relates to the publication of drug ingredient prices for multiple source drugs since 1987; and the third relates to the current implementation of the intravenous drug coverage under Medicare.

CONFISCATION OF EARNED DISCOUNTS

In 1984 HCFA undertook one of the most blatant antismall business policies that we have had to confront in recent years: the confiscation of earned discounts. The HCFA effort continues today and unfortunately has recently been endorsed by HHS Secretary Sullivan. The history of their devious campaign is long and complicated. It has touched our members in most of the states represented by the members of this Committee and of many of your colleagues. In fact, the Chairman and other members of the Committee have worked with us to prevent the confiscation of earned discounts. A central ingredient of the HCFA campaign has been to make a mockery of the RFA and for that matter the Administrative Procedures Act (APA).

Virtually the only substantive support for the HCFA policy is derived from a long since reputiated 1984 study conducted by the HHS Office of Inspector General (OIG). In short, the OIG recommended that the confiscation of our members earned discounts would yield an annual reduction of $128 million. Important to this mornings subject however, is the fact that the OIG found that without new regulatory authority HCFA would be unable to confiscate the earned discounts. This view was echoed by then HCFA Administrator Davis who had not only an unwillingness to recommend appropriate regulatory changes but also a basic concern about the merits of confiscating the earned discounts. Inspite of these facts various HCFA Regions, notably IV, VI, and VII, attempted to force their states to confiscate the earned discounts.

Clearly the agency had acted without authority and failed to comply with the RFA. Eventually after Congressional hearings and an expression of concern by HHS Appropriation Subcommittees and others, then Secretary Heckler ordered HCFA to cease and assist. Particularly important was an August, 1985 opinion from the Chief Counsel for Advocacy advising HCFA that if it intended to confiscate the earned discounts "the agency should institute a rule making in accordance with APA and the RFA".

In the summer of 1986 HCFA proposed reform for the Medicaid drug program: Three different proposals devoid of many essential details. No change in authority was sought persuant to the 1984 recommendation of OIG to confiscate earned discounts. Eventually, a final rule different from any of the three proposed was published in July and effective October 1987. The most important stated goal of the new regulation was to encourage state flexibility in the development of payment methods in the Medicaid drug program. On it's face the new rule appeared to be quite consistant with the Executive Order 12612, which asserted the importance of federalism in that "(t)here should be strict adherence to constitutional principles. Executive departments and agencies should closely examine the constitutional and statutory authority supporting any Federal action that would limit the policymaking discretion of the States and should carefully assess the necessity for any such action." (E.O. Federalism Consideration in an Policy Formulation and Implementation, 1987). However, in reality HCFA was apparently laying the ground work for defacto interpretative rules inconsistant with the RFA.

Incidentally none of the impacted small businesses were permitted an opportunity to comment on the 1987 regulations and certainly no genuine RFA analysis was conducted. While acknowledging it did not know the fiscal impact on pharmacy, HCFA did estimate that the 1987 regulations would result in $60 million reduction. Unfortunately, by the summer of 1988 the HFCA was at it again. They challenged the Medicaid plans of several states of Region VI in effect because they had not confiscated the earned discounts. Their campaign wages on inspite of the fact the OIG, the former HCFA Administrator and the Office of Chief Counsel for Advocacy's opinions that HCFA lacks the authority. Extensive efforts have failed to persuade the Administration to reject this antismall business initative. In fact in August of 1989 the HCFA, via an interpretative rule, instructed all states that they must confiscate the earned discounts. The Federal Court of Appeals for the Fifth Circuit is presently preceding with the law suit filed by the state of Louisiana against HHS regarding the confiscation of earned discounts.

The nation's retail pharmacists have reached the breaking point on this issue. Not only do these misguided attempts exceed HCFA's legal authority to modify pharmacists' reimbursement without following appropriate administrative procedures, they are generally poisoning the atmosphere for pharmacists' reimbursement. Prior to recent action by both Houses of Congress repealing outpatient prescription drug coverage under Medicare HCFA estimated that only 60-70 percent of all pharmacists would participate. In our view such estimates are very optimistric. This is inspite of the fact that most of the terms of pharmacy reimbursement were stated in the statute. That is no doubt because they have been taking it on the chin repeatedly under Medicaid. Unfortunantely, in recent proposed regulations for the Medicare drug program, now moot, HCFA even attempted to undermine these explicit terms.

For nearly one year HCFA has been headed by temporary managers. Worse yet, the rumor mill has it that a person very sensitive to drug manufacturers' interest and allegedly insensitive to retail pharmacy and consumer interests may be nominated for the post. The HCFA Administrator position now requires the consent of the Senate. We hope that the nomination process will prove to educate the nominee as to the importance of the RFA, APA and small business in general.

It is our intention to return to the Congress next year with a proposal which will enact by law the basic terms of pharmacy reimbursement for the Medicaid drug program.

MEDICAID DRUG INGREDIENT PRICES

Our second illustration of HCFA's failure to conduct a RFA analysis or even allow any review or comment, involves the publication of price changes for multi source drugs under the Medicaid drug program. Twice since the Medicaid regulations became final in October of 1987 the HCFA has provided state Medicaid agencies with such changes. First in June 1988 effective July 1988 and second in April of 1989 effective June 1989. These price changes significantly effect the reimbursement for all pharmacists under Medicaid. The 1987 regulations indicate the HCFA will publish the multi source drug list and any revisions to the list in Medicaid Program Instruction. There is nothing in the regulations that would lead a reasonable person to conclude that the development and content of such lists would not be subject to the APA and the RFA. Of course since there was no opportunity to comment on the 1987 rule there was no opportunity to ferret out the true intentions of HCFA. Had they been required to comply with current law another problem for our members could have been avoided.

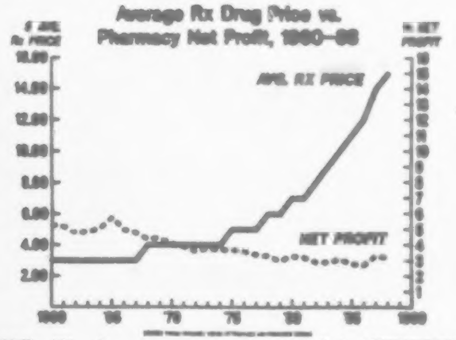
Our organization on behalf of independent retail druggists and the National Association representing chain drug stores, the other retailers involved with the Medicaid program, have strongly protested these practices. In fact all nine members of the Joint Commission of Pharmaceutical Practitioners (JCPP) have repeatedly objected to HCFA and more recently, August 1989, to HHS Secretary Sullivan. The member organizations of the Joint Commission of Pharmacy Practitioners, include the American Association of Colleges of Pharmacy (AACP), American College of Apothecaries (ACA), American College of Clinical Pharmacy (ACCP), American Pharmaceutical Association (APhA), American Society of Consultant Pharmacists (ASCP), American Society of Hospital Pharmacists (ASHP), National Association of Chain Drug Stores (NACDS), NARD and National Council of State Pharmaceutical Association Executives (NCSPAE).

MEDICARE IV DRUGS

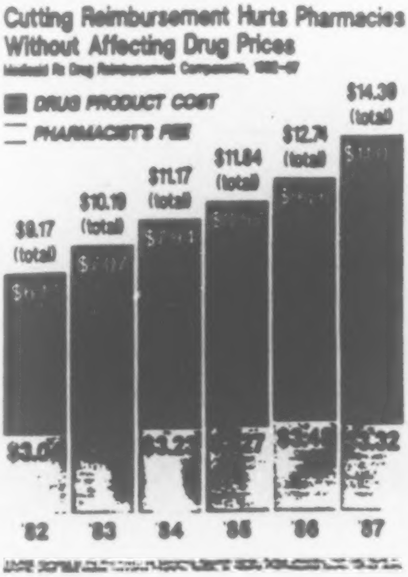
Our last example of HCFA's noncompliance with RFA and related statutes involves the development of regulations to implement the intravenous drug coverage provisions of the Medicare Catastrophic Act which President Reagan signed July 1, 1988. These provisions were scheduled to take effect January 1, 1990. General regulations on this subject were published September 7 and 8, 1989, with comments acceptable until November 5, 1989. As of this morning, 15 months after the enactment, however, the terms of reimbursement for pharmacies, with less then three months to implementation, have not been published. The Medicare Catastrophic Reform Act, S.1726, which the Senate unanimously approved on October 7, 1989 retains the IV coverage. However, the implementation date is postponed until 1991. We have requested HHS General Counsel to withdrawl the recently published intravenous regulations and request the Committee's assistance in helping us assure that if this benefit is retained that the letter and the spirit of APA and RFA are reflected in HCFA's actions.

CONCLUSION

As we mentioned earlier the basic purpose of the RFA is to assist agencies to achieve their objectives through rules and regulations sensitive to the concerns of small business. The Senate Special Aging Committee is conducting an investigation of prescription drug prices. In the Committee's July 1989, report it noted "that small retail pharmacies are being squeezed out of business caught between high drug prices and reimbursement by public and private payors who won't pay pharmacy fully for the incredible cost of drugs that sell". In our market place manufacturers charge retail pharmacists and the government, for example Medicaid, the highest prices. Others are given prices not based on economies of scale radically below these available to Medicaid or any retail purchasers. There are alternatives more sensitive to the concerns of retail pharmacy, consumers and other tax payors. The failure of HCFA to recognize the impact on small business of the multi-tier pricing practices of drug manufacturers has been a principal obstacle to achieving true economies in the Medicaid drug program. Namely through reforms other than the confiscation of the discounts our members earn. Since nonprofit entities obtain such special prices we have even advised some of our members to establish a nonprofit subsidary solely for their Medicaid patients. Afterall, Medicaid is a true charitable program. The following charts from the Senate Aging Committee illustrate the net impact of wrong-headed HCFA Medicaid policies in recent years:



Average Rx Drug Price vs. Pharmacy Net Profit, 1960–88



Cutting Reimbursement Hurts Pharmacies Without Affecting Drug Prices

The RFA has been a helpful tool in working even with agencies that ignore it. It has provided a context in such cases which has assisted supporters of independent pharmacists in the Congress and elsewhere by providing leverage necessary for political resolution of our problems. The provisions of S. 1458 once enacted and vigilant oversight of RFA will help assure lawfulness at the HCFA in the future or at least provide adequate remedies to effectively address future lawlessness at HCFA. Many private third-party prescription programs are copying HCFA imposed reimbursement schemes, so that our losses under Medicaid stand to be compounded in the private sector. Thus, the need to assess the indirect impact of HCFA proposals under RFA is crucial to the concerns of independent pharmacy. Lastly, we recommed that the Committe consider appropriate sanctions for conduct violative of the RFA; and that your recommendations to the Judiciary Committee include sufficient sanctions to help deter noncompliance.

Our members are major factors in the stability of their hometowns. They know their employees and customers. Often they provide the success models or symbols to the young and the not so young, of proof that the American dream of ownership and hard work is still what this country is all about. They support religious endeavors and other local institutions. In other words, they are leaders with a stake in the community who have, and are demonstrating daily, a commitment to local and national pride. They learned long ago that "big is not necessarily better!"

Much that they epitomize is under fire. Regretfully, the Federal Government, through agencies such as HCFA, is firing most of the shots!

Uppermost, our members want to continue owning and operating their pharmacies, providing vital, personalized health-care services for each of our communities. NARD solicits your assistance is any mutual effort which will permit them to continue to control their own economic and professional destinies.

It is our intention to submit a supplemental statement with exhibits to the Committee for the record that further documents the points we have addressed this morning.

On behalf of the officers and executive committee and the members of the National Association of Retail Druggists we thank you for the opportunity to continue to participate in helping to assure the full implementation of Public Law 96-354.

Attachments:

(a) Swain to HCFA August 2, 1985
(b) JCPP to HHS August 21, 1989

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

August 2, 1985

Carolyne K. Davis, Ph.D.
Administrator
Health Care Financing Administration
200 Independence Avenue, S. W.
314-G HHH
Washington, DC 20201

Dear Dr. Davis:

I am writing to express my concern with the procedures used by the Health Care Financing Administration (HCFA) to alter the methods that states use to determine Medicaid drug reimbursements. Specifically, I believe that no action should be taken until the report of the Task Force appointed by Secretary Heckler has been reviewed; then, if a change in regulations is necessary, the agency should institute a rulemaking and observe all appropriate administrative procedures, including the Regulatory Flexibility Act.

The Office of the Chief Counsel for Advocacy of the U. S. Small Business Administration was established by Congress under P.L. 94-305 (15 U.S.C. 634 et. seq.) to advocate the views of small business before the Congress and Federal agencies. The Office of the Chief Counsel for Advocacy is also charged with overseeing agency implementation of the Regulatory Flexibility Act. (5 U.S.C. 601 et. seq.).

As you know, states in Regions IV, VI, and VIII have been threatened with a reduction in federal funds if they do not eliminate or modify their use of average wholesale price (AWP) to determine the estimated acquisition cost (EAC) of drugs. AWP is a published list price that is not adjusted to reflect discounts that pharmacists may receive for good business practices, such as prompt payment, volume purchases, or payments in cash. The Department of Health and Human Services (HHS) Office of the Inspector General (OIG) has indicated that eliminating the use of AWP would result in annual savings of $128 million (See "Changes to the Medicaid Prescription Drug Program Could Save Millions," Audit Control Number 04-40216, p.3, hereafter "OIG Report").

Given the significant effect that such a reduction in reimbursements could have upon the many small retail pharmacists participating in the Medicaid drug program, HCFA should ensure that any changes in regulations or policy are achieved through proper administrative procedures. To the extent that HCFA mandates a particular method for determining EAC or effectively removes states' discretion to assess the EAC, the Administrative Procedure Act's notice and comment procedures, as well as the Regulatory Flexibility Act, may apply.

The OIG Report recommended that current regulations be revised to eliminate the use of AWP and provide states with criteria to use in determining EAC. The Administrator of HCFA's comments on the draft OIG Report (May 22, 1984) indicated that any change in current regulations would be premature, pending the findings of the Task Force appointed by the Secretary of HHS to review the drug reimbursement regulations. The Administrator further stated that elimination of AWP would create "undue hardships" for some states and that the agency should develop an alternative pricing mechanism before it changes the regulations to prohibit use of AWP. Given HCFA's recognition that the elimination of AWP would be a significant departure from existing practices and warrant a change in current regulations, it appears inconsistent that the agency's regional administrators would order states to stop using AWP, or suffer a reduction in federal funds.

One aspect of the Task Force's efforts was to conduct a public hearing that specifically requested comments on the impact of the regulations upon the retail drug industry (August 4, 1983). I believe that HCFA should continue to ensure that small businesses have the opportunity to participate in the regulatory process. The agency should not act until it accepts the findings of the Task Force and then, if action is warranted, the agency should institute a rulemaking in accordance with the Administrative Procedure Act and the Regulatory Flexibility Act.

I would be happy to provide any necessary assistance in implementing the Regulatory Flexibility Act.

Yours very truly,

Frank S. Swain
Chief Counsel for Advocacy

jcpp

JOINT COMMISSION OF PHARMACY PRACTITIONERS

AMERICAN COLLEGE OF APOTHECARIES
AMERICAN PHARMACEUTICAL ASSOCIATION
AMERICAN SOCIETY OF CONSULTANT PHARMACISTS
AMERICAN SOCIETY OF HOSPITAL PHARMACISTS
NARD - Representing Independent Retail Pharmacy

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Paul E. Galanti
Secretary

August 21, 1989

Louis W. Sullivan, M.D.
Secretary
Department of Health and Human Services
200 Independence Avenue, SW
Washington, DC 20515

Dear Mr. Secretary:

This letter is written on behalf of the member organizations of the Joint Commission of Pharmacy Practitioners, including the American Association of Colleges of Pharmacy (AACP), American College of Apothecaries (ACA), American College of Clinical Pharmacy (ACCP), American Pharmaceutical Association (APhA), American Society of Consultant Pharmacists (ASCP), American Society of Hospital Pharmacists (ASHP), National Association of Chain Drug Stores (NACDS), NARD (Representing Independent Retail Pharmacy), and National Council of State Pharmaceutical Association Executives (NCSPAE). These organizations, as a group, represent all facets of the profession and essentially all the pharmacists in this country. The member organizations of JCPP wish you well in guiding the important work of the Department of Health and Human Services (HHS).

The purpose of this letter is to inform you of a long-standing concern held by JCPP member organizations regarding the Health Care Financing Administration's (HCFA) notification process as it relates to the establishment of Medicaid prescription drug price changes and its failure to provide pharmacy related organizations with the opportunity to comment on proposed price changes and their burdensome financial implications for pharmacists. Although we have attempted to work with the previous administration to open a dialogue on this issue, our concern has yet to be given serious consideration.

During a meeting in October, 1986, we were led to believe that the issue might be resolved when HCFA Administrator Dr. William Roper assured JCPP members and other pharmacy related organizations that HCFA understood the fiscal impact that changes in the price limits would have on pharmacists. He pledged at this meeting that HCFA would provide an opportunity for public comment on proposed price changes through the NPRM process. Subsequent to this assurance, HCFA released, in June, 1988, "Transmittal No. 10," which included numerous and substantial decreases in reimbursement limits for prescription drugs paid for under the Medicaid program. The changes were made without public notice and did not provide affected parties the opportunity to comment.

Concerned about HCFA's obvious failure to honor Dr. Roper's pledge, JCPP member organizations, in December, 1988, wrote to Undersecretary Donald M. Newman asking for a reaffirmation of Dr. Roper's assurance that future changes in drug price reimbursement limits be made only after the appropriate NPRM and public comment. We informed Mr. Newman that HCFA's issuance of Transmittal No. 10 failed to comply with Executive Order 12291 and the Regulatory Flexibility Act, which requires the Agency to prepare and publish, for every major rule, an impact analysis which details costs in monetary terms and identifies who is likely to incur the cost.

In a February, 1989 response to our letter, Mr. Newman stated that there existed some misunderstanding of what Dr. Roper told JCPP member organizations during the October, 1986 meeting in question. He wrote in this letter that Dr. Roper was speaking about the rules for establishing the listing of upper limits, and that his commitment related to public notice and opportunity for hearing regarding those rules. He further indicated that this commitment had been fulfilled and that he was hopeful that his letter would clarify the process and explain why the Department proceeded as it did in publishing a recent update of the limits.

Mr. Newman's response did not address JCPP member organizations' position that HCFA had not honored its commitment to publish Medicaid prescription drug price changes as proposed rules for public comment. Regardless of Mr. Newman's comments, the fact remains that HCFA has yet to recognize the significance of our concern and the far-reaching impact of its present refusal to request public comment on these changes.

We ask that you give this issue serious consideration. We look forward to your response and are prepared to work with you in developing a fair and reasonable notification process.

Sincerely,

Carl E. Trinca
American Association of Colleges of Pharmacy

D. C. Huffman, Jr.
D. C. Huffman, Jr.
American College of Apothecaries

Robert M. Elenbaas
Robert M. Elenbaas
American College of Clinical Pharmacy

John A. Gans
American Pharmaceutical Association

R. Timothy Webster
American Society of Consultant Pharmacists

Joseph A. Oddis
American Society of Hospital Pharmacists

Charles M. West
Charles M. West
NARD - Representing Independent Retail Pharmacy

Ronald L. Ziegler
National Association of Chain Drug Stores

Paul E. Galanti
Paul E. Galanti
National Council of State Pharmaceutical Association Executives

Senator **Burns**. I am turning the gavel over now to the Chairman. I have but one question.

I guess with all these rules and regulations, should you cut your outfit down? I would imagine that all your customers down there in the southeastern part of Wyoming would have to go to Scotts Bluff; is that correct?

Mr. **Vandel**. Right now, Nebraska does not fill Wyoming welfare prescriptions, but you can see the dilemma it places us in. Morally, you have to take care of these people. Yet, in doing so it is a burden, and at what point do you finally decide I have to back away? You can only cost-shift so much with the increase of third party to approximately 30 percent, and with many pharmacies well over 80, 85, 90 percent third party business, there is no place else to shift.

Senator **Burns**. Thank you very much.

He is the first of this panel, Mr. Chairman. You have Dr. Cahilly and Ms. Douglas yet to testify.

I have to run back over to an Energy meeting. Welcome back.

Senator **Wallop**. Conrad, thank you very much. My apologies for not being here to hear these witnesses and those who preceded them, especially the Members of Congress.

Let us finish the panel, and then we will question them individually.

John, it is a great pleasure to welcome you here. I am sorry I was late and not able to be here for your testimony.

Mr. **Vandel**. Thank you.

STATEMENT OF DR. GLENN CAHILLY, EXECUTIVE VICE PRESIDENT, LANCASTER LABORATORIES, INC., LANCASTER, PA, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE

Dr. **Cahilly**. Senator Wallop and Members of the Committee, I am Glenn Cahilly, executive vice president of Lancaster Laboratories, Inc. of Lancaster, PA. Our company is an independent laboratory providing analytical services to a wide range of clients in the environmental, industrial hygiene, food, and pharmaceutical areas. We were founded in 1961 by our current president, Dr. Earl Hess, with a staff of three. We now employ 360 and remain privately held.

I am here to testify on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce, trade, and professional associations.

Recognizing the magnitude of the regulatory problem facing the small business community, Congress enacted the Regulatory Flexibility Act of 1980 to ensure that Federal regulations would not unnecessarily or disproportionately burden small businesses. The chamber supported the act and also Executive Order 12291 of 1982. Since then, two other laws have been enacted that address the public's concern for the Federal regulatory burden: the Paperwork Reduction Act and the Equal Access to Justice Act.

We see these acts and the Regulatory Flexibility Act in particular as a means to promoting responsible legislation. In any business, small or large, it would be unthinkable for the leaders to issue rules without extensively studying the projected impact, and without committing to follow up efforts to determine the actual impact.

We, therefore, support vigorous implementation, rigorous application, and further strengthening of the Regulatory Flexibility Act of 1980, and recommend that the proposed amendments to the act be favorably reported to the full Senate for immediate action.

Our formal statement, which you have and which I request be entered into the record, describes a number of dimensions of the Regulatory Flexibility issue that are critical to small businesses. These were compiled with the help of the chamber staff members who are in touch with a large number and variety of small business constituents.

Rather than using this time to recite the issues outlined in our statement, I would like to focus on one issue that impacts most all of us in small business; that is, the application of the Regulatory Flexibility Act to the Internal Revenue Service's rules.

For a number of years, small businesses have testified at congressional hearings regarding the IRS' refusal to consider applying the Regulatory Flexibility Act to its rules. Congress addressed this issue in the debates involving the Taxpayer Bill of Rights—P.L. 100-647—in 1988. At that time, Senator David Pryor introduced amendments that would have limited the IRS' ability to escape RFA analysis by claiming their rules were interpretive. His amendments were rejected, however.

Instead, a provision requiring the IRS to submit their proposed rules to the SBA's Administrator for comment before adoption was added. In practice, this means only that a copy of the Federal Register notice is sent to the SBA when public comment is solicited. Thus, in reality, there is no requirement in the Taxpayer Bill of Rights which obliges the IRS to take into account the comments of the SBA or to issue regulations in any different manner.

The full significance of the IRS' attempts to avoid accountability comes into focus when we consider the Section 89 fiasco. In the PRA clearance filing with OMB, the IRS estimated that an average of 10 to 12 hours would be required for a company to comply with the dictates of Section 89. This estimate was not only ludicrous, it was unrealistic to the point of irresponsibility.

At least 2 of those 10 to 12 hours are required to simply read the 44 pages of regulations that spell out Section 89 in the Federal Register. Our company, Lancaster Laboratories, viewed Section 89 seriously and, by the implementation date of January 1, 1989, had taken all the steps necessary to be in full compliance.

But 10 to 12 hours? No! In addition to sending several executives to day-long seminars on the topic, we spent literally hundreds of hours ourselves, and more with our consulting tax accountants and attorneys deciphering the regulation and conducting the requisite series of discrimination tests. Compliance made it necessary to add 43 pages of explanation to our company's personnel manual. Needless to say, we spent many thousands of dollars dealing with the IRS' Section 89, and we are still at a loss as to how to equitably apply the equivalency test to our start-up joint ventures, one in Houston, the other in Salt Lake City, which fall under the section's affiliated services group requirements.

It now appears, of course, that the regulatory chaos created by Section 89 is being recognized by Members of Congress and changes are being called for. This is wonderful. Everyone at Lancaster Laboratories and thousands of other small businesses are awaiting the outcome with baited breath.

Mr. Chairman, I am not here to plead for our release from adherence to responsible business practices. Nondiscrimination in employment, procurement integrity, and environmental stewardship are only a few of the many examples of responsibilities which must be carried by those who would lead a business. What frustrates us is what happens to positive concepts of social responsibility between the time they are conceived by the Congress and the time we encounter them in the form of regulations. A promising answer to this problem depends upon the success of your efforts to strengthen the Regulatory Flexibility Act of 1980.

The chamber appreciates this opportunity to present its views on this vitally important issue. Thank you, sir.

[The prepared statement of Dr. Cahilly follows:]

Statement of the U.S. Chamber of Commerce

ON: THE REGULATORY FLEXIBILITY ACT OF 1980

TO: SENATE COMMITTEE ON SMALL BUSINESS

BY: GLENN CAHILLY

DATE: OCTOBER 17, 1989

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents nearly 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 93 percent of the Chamber's members are small business firms with fewer than 100 employees, 45 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—numbers more than 10,000 members. Yet no one group constitutes as much as 32 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 59 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
THE REGULATORY FLEXIBILITY ACT OF 1980
before the
SENATE COMMITTEE ON SMALL BUSINESS
for the
U.S. CHAMBER OF COMMERCE
by
GLENN CAHILLY

October 17, 1989

Mr. Chairman and members of the Committee, I am Glenn Cahilly, Executive Vice President of Lancaster Laboratories, Inc. located in Lancaster, Pennsylvania. My company is an independent laboratory providing chemical and biological services to a wide range of clients in the food, environmental, and pharmaceutical areas.

I am here today testifying on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce, trade and professional associations. The Chamber is pleased to present its views on this most critical issue.

The Chamber supported the Regulatory Flexibility Act of 1980 (RFA) and Executive Order No. 12291 of 1982. We strongly recommend that the proposed amendments to the RFA of 1980 under consideration by this Committee be favorably reported to the full Senate for immediate action.

Since 1980, three laws have been enacted to address the public's concerns over issues related to federal regulatory burdens: the Paperwork Reduction Act (PRA), the Equal Access to Justice Act (EAJ), and the RFA. Parenthetically, we support the reauthorization of the PRA and the continuation and expansion of the Office of Information and Regulatory Affairs (OIRA).

Recognizing the magnitude of the regulatory problem facing the small business community, Congress enacted the RFA of 1980 to ensure that federal regulations would not unnecessarily or disproportionately burden small businesses. The law explicitly recognizes that the size of a business, unit of government, or nonprofit organization frequently has a bearing on its ability to comply with a federal regulation.

The RFA mandates that the federal government review all regulations on which public comment is required by the Administrative Procedure Act (APA), Section 553(b), or any other law to determine whether maximum flexibility is being provided to accommodate the unique needs of small businesses. An "initial regulatory flexibility analysis" is required to identify: (1) the reasons for an agency's considering action; (2) the objectives and legal bases for a proposed rule; (3) the kind and number of small entities to which the proposed rule will apply; (4) the projected reporting, recordkeeping, and other compliance requirements of the proposed rule; and (5) all federal rules that may duplicate or conflict with the proposed rule.

If the promulgating agency certifies that the rule does not have a "significant full impact on a substantial number of small entities," a full regulatory flexibility analysis is not required. However, the agency still must perform some regulatory analysis to make such a determination.

For all final rules, the RFA requires an agency to publish a "final regulatory flexibility analysis" to: (1) summarize the issues raised by the public comments; (2) summarize the agency's assessment of those comments; (3) state any changes made in the proposed rule as a result of those comments; (4) describe each significant alternative to the rule consistent with the regulatory objectives; and (5) state the reasons for each alternative's being rejected.

The RFA applies to every federal rule for which notice and comment are required by Section 553(b) of the APA or any other law. The APA does contain some exemptions, the most notable of which is for interpretative rules. Interpretative rules are those that are intended only to implement a statute in which Congress has not delegated legislative-type authority to an agency. One rationale for exempting interpretative rules from "notice and comment" rulemaking is that the agency is only following the specifics of the legislation and has little or no discretion to change the rules. Nevertheless, agencies often have considerable discretion in promulgating interpretative rules or in classifying rules as interpretative, which can result in misinterpreting Congress's intent.

To illustrate the problem, I shall highlight several specific areas that have imposed unnecessary burdens on my company.

These examples demonstrate the cumulative effect of regulatory burdens on different functions of the same business.

As standard practice, our company carefully monitors new legislation and resulting requirements. Lancaster Laboratories learned that Section 89, which requires employers to conduct a complicated series of tests to prove that their health and other benefit plans do not discriminate in favor of highly compensated employees, was to be implemented on January 1, 1989. We viewed this seriously and took all necessary steps to be in full compliance. Our company incurred significant internal and external expenses in order to have our documents in compliance by that date. Now that we have incurred the cost, it appears that Congress recognizes how extreme Section 89 regulations are and that they should be changed. Nevertheless, to comply with changes will cost us additional dollars.

While Section 89 is extremely complicated to apply to a single business, Lancaster Laboratories also is engaged in one joint venture and is in the process of establishing another. These joint ventures fall under the "affiliated services" group requirements of Section 89. The equivalency tests are so complicated to conduct that our company must have one benefit practices system for all three. This is senseless because living situations differ in Lancaster, Salt Lake City, and Houston where the ventures are located. Burdens include having our Pennsylvania-based insurance company extend services to each site because local insurance companies do not offer similar packages.

The Employee Retirement Income Security Act of 1974 (ERISA) also incorporated some of the same affiliated service group rules. Lancaster Laboratories worked for years to develop the financial stability to introduce a 401(k) plan with liberal benefits and profit-sharing. Now we are required to offer the same benefits to employees of our start-up companies, which have yet to make a profit. This has an adverse effect on employee morale.

Documentation to assure that employees know all the benefits falling under Section 89 and ERISA added 43 pages to our Personnel Manual this year.

In the PRA clearance filing with OMB, the Internal Revenue Service (IRS) estimated an average of 10 to 12 hours per company to comply with Section 89. This estimate does not cover even the minimum number of hours required by the very smallest employer. In addition to this unrealistic time estimate for comprehending the law, gathering data, and conducting tests, there are time burdens for collecting sworn statements from employees who have other medical coverage and for collecting information on former employees.

The complexity of the tests imposed by Section 89 and the 44 Federal Register pages of regulations that go with it is out of proportion to the legislation's stated goals. Other Chamber members have told us that Section 89 is the most "time-consuming, paper-producing nightmare" that they have ever seen. As one member wrote, "When you add Section 89 to the requirements of the Immigration Reform Act, Consolidated Omnibus Budget Reconciliation Act, health and safety regulations, affirmative action plans, etc., believe me, I am developing a mountain of paper."

Affirmative Action

As an employer with more than 50 employees and a government contract of more than $50,000, Lancaster Laboratories is subject to an Affirmative Action Audit under the Office of Federal Contract Compliance Programs. In 1988, we expended approximately 600 hours of staff time, at a cost of more than $8,500, preparing and facilitating this process. Incidentally, the final paperwork package weighed 13 pounds.

Our experience with this process was extremely negative. We pride ourselves on applying the spirit as well as the letter of the law in our equal opportunity efforts and have worked with social service agencies in our area to recruit and train minority and disadvantaged workers. The government auditor was not at all interested in good faith efforts but extremely interested in "nit-picking." For example, we followed the department's written regulations and typed a list of employees beginning with the lowest paid and moving to the highest paid. The auditor preferred the reverse order (listing highest paid first), which necessitated the staff's working overtime.

In another example, Lancaster Laboratories was asked to determine the availability of minorities within areas in which we recruit to match those percentages in our work force. Obtaining that information is all but impossible, as our contacts with 41 recruiting sources, including vocational-technical schools, business schools, and science departments in colleges, demonstrated.

It is to the advantage of small business and the federal government to create contractual relations. Unfortunately, the complexity of regulatory compliance is often overwhelming. In our small business, we are forced to have one full-time staff contract specialist simply to work with legal aspects of this complexity.

From a national perspective, the application of the RFA to IRS interpretative rules, many of which have a significant economic impact on a substantial number of small businesses, has been the subject of several Congressional hearings. For a number of years, small businesses affected by IRS rules have testified regarding the agency's refusal to consider applying the RFA to its rules. Congress obliquely addressed this issue in the Taxpayer Bill of Rights in 1988.

During consideration of the Taxpayer Bill of Rights, contained in P.L. 100-647, the applicability of the RFA to IRS rules was debated during Senate Committee on Finance markup of the bill. Senator Pryor introduced amendments that would have severely limited the IRS's ability to escape RFA analyses by claiming that its rules were interpretative. The Committee rejected his amendments and instead added a provision requiring the IRS to submit its proposed rules to the Small Business Administrator for comment before their adoption. In practice, this means only that a copy of the Federal Register notice is sent to the Administrator at the same time public comment is solicited; this is no improvement over the current requirements of the RFA, and the Taxpayer Bill of Rights does not require that the IRS take into account the comments of the Administrator or issue regulations in any different manner.

Section 611 of the RFA, entitled "Judicial Review," states that:

> (a) Except as otherwise provided in subsection (b), any determination by an agency concerning the applicability of any of the provisions of this chapter to any action of the agency shall not be subject to judicial review.

Although this section clarifies the intended role of a court in the examination of rules and regulatory flexibility analyses, the administration of the RFA would suggest that there was some ambiguity in Congress's approach to the issue of judicial review.

Under this section, neither regulatory flexibility analysis nor agency compliance or noncompliance with the provisions of the RFA is subject to judicial review.

In effect, Congress subordinated the value of compliance induced by judicial oversight to the values of administrative efficiency and uninterrupted decisionmaking. Even though nonreviewability of the certification process may frustrate the RFA's purpose, Congress chose to take this risk rather than to open the process to litigation.

One of the leading cases in this area Lehigh Valley Farmers v. Block, 829 F.2d 409 (1987), highlights the confusion regarding this section of the RFA and the critical need for Congress to provide for the availability of judicial review in contested regulatory flexibility analysis cases.

In the Lehigh Valley case, a group of dairy producers asserted that the Secretary of Agriculture's decision to certify a rule failed to comply with the requirements of the RFA. The Secretary had determined that changes in certain milk marketing orders would not have a significant impact on a large number of small entities, and the plaintiffs contended that the certification of no tangible impact was incorrect. While the Court sided with the plaintiffs, it recognized that the core of the debate was whether or not it could review the Secretary's decision to certify. The Court reluctantly concluded that certifications were not reviewable, in part because the legislative history on this point was not definitive. The Court's decision stated that "it is for Congress to correct this anomaly. . . ." We strongly agree.

Today, more than 100 federal agencies maintain thousands of regulations that have an enormous impact on how we live and what we do. Regulations tell us what is safe and what we can buy. Government regulates how we make, price, sell, transport, and discard products of everyday American life.

According to the Small Business Administration, in 1988 the cost of economic regulation was estimated to be between $50 billion and $100 billion per year. Regulatory costs average between $570 and $1,700 per household each year. These burdens do not fall equally on all businesses: the proportionate cost of regulatory compliance for small firms is almost three times that for large firms.

Many companies have been forced to hire employees solely for the purpose of complying with regulatory requirements; these additional employees add significantly to the costs of goods and services. Parenthetically, the result often is higher, less competitively priced U.S. products.

Although Congress intended for small businesses to be a primary beneficiary of the RFA, its implementation has not resulted in their receiving the full benefits anticipated when it was passed. The Chamber respectfully asks that in addition to the amendments under consideration by this Committee the Committee also consider the following recommendations, whicn, we believe, would strengthen implementation of the RFA.

Oversight of RFA should be broader.

We recommend that OIRA play a broader role in overseeing the regulatory analysis process. Its centralized position provides a number of opportunities for it to play a more supportive role in promoting the integration of regulatory analysis into agency decisionmaking. For example, OIRA should monitor the procedures used by the agencies in integrating regulatory analysis into the regulatory decisionmaking process and should monitor the resources available to the agencies to fulfill their analytical responsibilities. OIRA should also broaden its effort in promoting the adoption of innovative techniques as an approach to reducing costs, rather than simply establishing less restrictive standards. OIRA should play a more active role in reducing conflicts and overlaps and promoting greater consistency in regulatory policies. It should also promote the development of consistent methodologies for measuring regulatory impacts.

Guidelines to standardize and reduce use of waivers should be developed and rationale should be public.

We recommend that OIRA develop written guidelines for waiving the analysis requirement to replace the implicit guidelines that are now in effect. OIRA should apply the regulatory analysis requirement more consistently, and a full public explanation should be provided when waivers are granted. While an emergency situation, lack of discretion, or ample existing analysis might justify waiving a regulatory analysis, agencies should be required to demonstrate, both to OIRA and to the public, that such conditions exist. Deregulation or intended reduction of regulatory costs should not be a basis for waiving the requirement. Actions that reduce regulatory burdens but that nevertheless might generate significant adverse consequences or substantial cost increases to segments of the population should still be thoroughly analyzed. Only where a substantial body of evidence shows a likelihood of a net gain without serious adverse consequences should a waiver be considered. However, even then a waiver should not be automatic because, where existing analysis is plentiful, it should not be difficult for the agency to issue it as a regulatory analysis.

Attention to resources is needed if objectives of regulatory analysis requirement are to be achieved.

The regulatory analysis requirement is unlikely to achieve its objectives if agencies are not provided the necessary resources. We have found that the costs of preparing regulatory analyses are substantial and believe that they are likely to grow. Congress might require OIRA and/or the agencies to provide information on what resources the agencies have for preparing regulatory analyses and on whether there is a disparity between the resources available and those required for meeting the substantive requirements of statutes. More attention might also be directed at establishing criteria for allocating analytical resources to those regulations that will benefit most from them.

Review of regulatory legislation can help to remove barriers to more cost-effective regulation and reduce potential of agency rulemaking displacing Congressional intent.

To help to remove statutory barriers to cost-effective regulation and reduce the likelihood of agency rulemaking conflicting with Congressional intent, Congress should consider reviewing existing regulatory legislation. Because most regulatory legislation was enacted in the absence of an administrative or statutory regulatory analysis requirement, the effect of such a requirement was generally not considered when the legislation was written. As a result, the implementation of the legislation after becoming subject to a regulatory analysis requirement may be different from what Congress intended, especially if the original legislation granted the agency broad discretion. Congressional committees with responsibility for substantive regulatory legislation should consider amending existing legislation to take into account the fact that, absent any statutory directions to the contrary, a cost-benefit standard may now be applied.

Congress may wish in some cases to remove language that prevents agencies from considering costs or to clarify goals in terms of performance so that agencies are permitted to seek the most cost-effective means of achieving those goals. In regulatory legislation involving areas where costs and benefits are often intangible and difficult to measure, Congress may wish to provide agencies with additional guidance on how intangible costs and benefits should be evaluated for purposes of including them in a regulatory analysis. In cases where Congress develops or retains legislation that precludes agency discretion to balance objectives, the importance of Congress's considering costs and uncertainty is heightened.

The Chamber appreciates this opportunity to present its views on this most important issue. I would be pleased to respond to your questions at this time.

Senator Wallop. Dr. Cahilly, thank you very much.

Ms. Douglas.

STATEMENT OF SALLY L. DOUGLAS, ASSISTANT DIRECTOR OF FEDERAL GOVERNMENT REGULATIONS, POLICY AND RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Ms. Douglas. Thank you, Mr. Chairman.

It has been almost 10 years since the Regulatory Flexibility Act was enacted. It has been even longer since it was first considered. Consideration really began around 1977, so it kind of seems fitting that we are here today to conduct a review of the implementation of the act and to discuss ways to improve its operation.

The fact that Regulatory Flexibility has met with less than unqualified success since its enactment is perhaps not surprising considering the level of opposition that existed since the beginning of consideration of this act. When you consider that in 1977 to 1978, 87 Federal agencies commented to the Senate Judiciary Committee and only the General Accounting Office from the beginning was strongly supportive of the act, in addition to which the Administration at that time opposed the enactment of the act, it is really not surprising that the agencies over the years have done less than an adequate job overall in terms of implementing this act.

Obviously, with the kind of opposition that we faced in the early stages, congressional supporters and small business representatives had to create both a compelling case of the need for the act and be able to assure agency opponents that the act was not in any way intended to interfere with the day-to-day operations in fulfillment of their missions.

In achieving that second goal, we had to make some compromises in the original language, the ultimate effect of which we supporters had serious concerns. These concerns have brought us here today to discuss S. 1458 which would, in my opinion, clarify original congressional intent regarding the Regulatory Flexibility Act.

I say that because most of the points that are addressed in this bill you will find in the hearing records from 1977: The points on direct and indirect effect, the points on certification and how that factors into judicial review, the fact that whether or not a rule had a beneficial or negative impact, Regulatory Flexibility analyses were supposed to be performed, are all in there. They have just been, for various reasons, ignored or overlooked.

While the written statement that we submitted for the record does not indicate outright our support, I would like to state for the record right now that NFIB is strongly supportive of this act and will work with you to make sure that it is enacted.

Senator Wallop. Thank you.

Ms. Douglas. Some unintended loopholes in the law exist. That is, in my opinion, what this bill addresses, because the act is really supposed to be a catalyst for a practical working relationship between the agencies and small businesses, because it is supposed to promote more responsible rulemaking.

Unfortunately, in some instances the somewhat murky language of the act, the compromises that I mentioned earlier, and so forth, have interfered with that process. Most notably, the Internal Revenue Service's unwillingness to comply with the letter or the spirit of this act has been most distressing, although I have to say it is not really surprising. It was more or less expected.

Some of the witnesses have already mentioned such things as Section 89. It is patently absurd that there was never a Regulatory Flexibility analysis done on Section 89 because it has such an obvious impact on small firms. So we are very pleased to see that your bill contains language that would make sure that IRS is covered by Regulatory Flexibility and does have to comply.

The point of this act is that it can only work as the original report said. Meaningful regulatory reform must be governmentwide, must be enforceable and coordinated with the legislative framework for the Agency. It seems to me that there was a significant problem in terms of the way that the judicial review section was enacted. It was by far the most controversial provision in the consideration of the bill, and that is probably why it ended up being obscurely worded.

We already have had at least one instance where the courts have ruled that certification is not subject to judicial review, and that was not the intent. So again, we are pleased to see that there is language in the bill that would clarify that point as well.

As an aside, I would also like to mention that over the years another notable Agency has declared itself exempt, the Department of Defense, on the grounds that the APA does not cover matters of national security. I would put it to you that the massive procurement rules and regulations that are issued by the Department of Defense may or may not have to do with national security, but they certainly have an impact on small business. I would urge you to consider including language to cover those kinds of regulations under the Regulatory Flexibility Act.

I think that the language of the bill is eminently reasonable. As I have stated, I think that it does nothing more than clarify original intent, and it will or should have the effect of increasing public participation and increasing compliance. Obviously if you can tailor regulations to fit resources, you have a much better chance of people being able to comply as opposed to, in some instances, trying to ignore the regulations simply because they would have to go out of business.

I think your changes to Section 603 are a natural extension of the statute's original language, wholly consistent with its purpose. Again, I will state that both direct and indirect effects can be equally onerous on a small firm, and there is no reason why an analysis should not be done in the case of a beneficial change as well as a negative because it should be part of the normal rulemaking record.

At that point, I would just like to reiterate our support, and I will be happy to answer any questions you may have.

[The prepared statement of Ms. Douglas follows:]

NFIB

National Federation of Independent Business

STATEMENT OF

SALLY L. DOUGLAS

ASSISTANT DIRECTOR OF FEDERAL GOVERNMENTAL RELATIONS

POLICY AND RESEARCH

BEFORE: Senate Small Business Committee
DATE: Tuesday, October 17, 1989
SUBJECT: S. 1458, Amending the Regulatory Flexibility Act (P.L. 96-354)

Mr. Chairman, the National Federation of Independent Business and its over 570,000 small business owner members appreciate this opportunity to comment for the record on S. 1458, amendments to the Regulatory Flexibility Act enacted in 1980. At the outset we would like to commend the committee for holding these hearings and for recognizing the importance of a strong Regulatory Flexibility Act.

Mr. Chairman, regulatory reform is a serious priority for small business. Indeed, government regulation is the way business owners feel the "hand of the federal government" in their business operations. Whether direct or indirect, the implications of

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federal regulation can be draining on a small firm. Often small business owners simply do not have the time or resources to pore over the Federal Register searching for pertinent regulations, and many do not understand the reporting and recordkeeping requirements. Outside professional help is all to often necessary. In fact, a whole industry has grown up around providing information and guidance to businesses on how to cope with government regulations.

As was pointed out during the original debate on the Regulatory Flexibility Act, the attempt to standardize regulations frequently produces diseconomies of scale in regulatory compliance. That is, the application of uniform regulatory mechanisms often creates unintended barriers to market entry, development of new products, and reduction of competition because smaller firms are hit so much harder, proportionally, by federal regulations. Small entities simply are not equipped to deal with many government regulations. Having one set of rules for all businesses is often counter productive, or at the very least excessively burdensome for smaller firms.

The Regulatory Flexibility Act, passed in 1980, was an excellent first step in dealing with this important problem. Its clear and reasonable purpose is to have agencies analyze proposed regulations, assess potential impact on small entities, and lessen the regulatory burden whenever possible.

Agency experience with Reg Flex has been mixed. Some have ignored the bill or performed inadequate analyses. For example, during modification of OSHA's Hazard Communication Standard in 1987, which affects millions of businesses, OSHA failed to perform a proper reg flex analysis and grossly underestimated the cost of the rule. Significant alternatives were never evaluated. Easing the implementation burden and making the rules more relevant to smaller firms would have enhanced business compliance with HazComm. Instead, OSHA lost the opportunity by disregarding Reg Flex.

Other agencies have done a better job of complying with the Act and tailoring regulations to make them more practical for small business. The Environmental Protection Agency, for example, performed an extensive regulatory analysis for its underground storage tank program. The rules would affect up to one million small businesses and cost billions of dollars per year. EPA's analysis included several alternatives in the areas of leak detection and prevention, and financial responsibility. The final rule, which came out in October of 1988 lessened the regulatory burden for smaller firms.

There are, however, several loopholes in the law which must be closed in order to fulfill the objectives of the original bill. The Act should be a catalyst for a more practical working relationship between the federal government and small firms and, therefore, bring about more complete and willing compliance with the laws of the land. But federal agencies must be committed to compliance with the letter and spirit of regulatory flexibility.

Interpretive Rulings: IRS

Section 601 of the RFA exempts so-called "intrepretive" rules, based on an exemption in the Administrative Procedures Act. Generally speaking, interpretive rules do not pose major problems for small entities, with one MAJOR exception -- the Internal Revenue Service.

Shortly after Reg Flex was enacted, the IRS declared itself exempt from the law. IRS claims that their rules only implement Congress-passed policy and are therefore predominantly interpretive. NFIB disagrees.

In point of fact, the undisputed original intent of the law was to include all agencies within the purview of Reg Flex. Indeed, the Senate Judiciary Committee's report expressly stated:

> "The Committee believes that meaningful regulatory reform must be government-wide, enforceable, and coordinated with the legislative framework for the agencies" (emphasis added)

According to the SBA's 1988 Reg Flex Implementation Report, IRS has not performed one regulatory flexibility analysis since the astonishing tax code modifications made in the Tax Reform Act of 1986.

NFIB considers it extremely ironic that the one agency which affects all small businesses has exempted itself from the Act. Classifying it as an interpretive rule, IRS declared Section 89 exempt from a regulatory impact analysis. Did anyone, including IRS, benefit from IRS' hiding behind the "interpretive" classification to avoid Reg Flex? I don't think that there is a single individual anywhere who would argue that the proposed Section 89 rules would have no significant impact on small entities. IRS' interpretive rule classification of Section 89 was not only incorrect, it was ludicrous, and illustrative of the type of damage that can be done by such a loophole.

APA's Exemption for "National Security" Functions: DoD

The Department of Defense is the other agency that consistently avoids compliance by exploiting a loophole in the original bill. On the basis that the APA does not cover military or national security functions, DoD has extrapolated to exempt all DoD regulations from the Act. This leaves, for example, the myriad of procurement regulations with no protections for small contractors.

Judicial Review

The issue of judicial review within the Regulatory Flexibility Act has had a long and colorful history. As passed, the Act tried to guard against stalling the regulatory process while still using judicial review to pressure agencies to comply. Any Reg Flex analysis performed by an agency becomes part of the rulemaking record and thus may be reviewed if there is a later court challenge. However, rulemaking cannot be challenged on the basis of the RFA alone and is hardly ever challenged when an analysis has been done.

More problematic is the area of improper certification that a rule has no significant impact on small entities. Agencies in effect hide behind certification decisions in order to avoid compliance with RFA. In the case of Lehigh Valley Farms v. Block, 1986, while the appeals court agreed that the certification was incorrect, it ruled that agency certifications are not reviewable at all. The court suggested that Congress should "correct this anomaly". NFIB agrees.

Without an effective procedure to challenge agency certification, the regulatory process becomes even more of a barrier to small business. While we appreciate the balance the authors tried to achieve, the Act is virtually meaningless without definitive judicial review language. Sen. Wallop's language to open up certification for review is eminently reasonable and would increase public participation. Correcting this would serve to encourage small business participation in the regulatory process and improve agency attention to the RFA and its original purposes.

Indirect Effects

S. 1458 also recommends new language to recognize the indirect impact regulations may have on small business customers and clients, which so often go unmeasured.

Senator Wallop's changes to Section 603 are a natural extension of the statute's original language and wholly consistent with its purpose. Specifically, clarification language calls for expanding the definition of "impact" to include "those effects which are directly and indirectly imposed by the proposed or final rule and are beneficial and negative." Again, this only clarifies the language to be consistent with original legislative intent. It will encourage better public participation and a better idea of the true burden posed by federal regulations on small entities.

Conclusion

As you well know, Mr. Chairman, restricting competition at some point becomes a cost to the consumer. It makes good political and economic sense, then, to make allowances to help small entities comply with federal regulations -- increased competition will result.

S. 1458 makes three much needed changes in the Reg Flex law. Bringing IRS back under the purview of the law, as originally intended, would go a long way toward granting regulatory relief for small entities including small cities, counties, towns, townships, school districts, and not-for-profits, as well as for the country's millions of small businesses. Strengthening judicial review will give the agencies more of an incentive to comply. And acknowledging that federal regulations can have an indirect impact on smaller entities should help improve agency analyses.

Along with the Paperwork Reduction Act, which I might add is currently being reviewed by both Houses, Regulatory Flexibility affords us the valuable opportunity to increase public participation in the regulatory provess and still allow federal agencies to perform their functions for the common good. With a strong, committed effort by the agencies, both can succeed.

In sum, the valuable goals of the original Regulatory Flexibility Act have been undermined by unintended loopholes and weak enforcement language. Sen. Wallop's bill would address the most important concerns expressed by supporters of Reg Flex and I would urge members of the committee to cosponsor S. 1458. NFIB stands ready to work for its swift passage.

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Senator **Wallop**. Thank you, Ms. Douglas.

One of the interesting things that has come up in the Judiciary Committee especially is that by providing this expanded judicial review we will overload the cart. It seems to me that what they are saying is they are conceding that the agencies are not following a darn thing. There is no reason to overload the cart if you follow its intent and purpose.

Bob, would you like to address the panel.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator **Kasten**. Mr. Chairman, thank you.

First of all, Dr. Cahilly, we are going to repeal Section 89, so do not worry about that. We had an overwhelming vote in the House of Representatives. We now have strong support here, and I do not think there is any question, notwithstanding the fact that some of these issues have been dropped from different reconciliation proposals. Section 89 will be repealed. It will not be reformed. It will be repealed, and it is clear that that is the direction we need to go in. I am sorry that you spent as much time and effort as you have. Unfortunately, you are not alone.

Dr. **Cahilly**. I would assume it is all deductible. [Laughter.]

Senator **Kasten**. Notwithstanding the fact that it is deductible, it is still a waste of money.

Sally, you mentioned the Department of Defense. Is there anything that this legislation, S. 1458, should include with regard to the Department of Defense?

Ms. **Douglas**. I cannot off the top of my head give you exact language, Senator, but the bill is very clear in terms of bringing IRS' interpretive rules under consideration of the bill. There probably needs to be another paragraph and possibly a specific citation on procurement rules and regulations.

That has nothing to do essentially with the internal workings of DOD. It has to do with those regulations that impact the public. So I would be happy to work out some language to that effect, but I do not think the bill as it is currently constituted will bring DOD under the umbrella, and I do think they need to be.

Senator **Kasten**. Let me just expand on that question. Are there other shortcomings?

I think all of us recognize and agree with your statement that all we are doing is trying to pin down the original intent of this legislation. We are trying to take the loopholes out.

Are there loopholes in addition to the Department of Defense that you see? In other words, are there other places that we ought to be addressing this same set of problems that are not referenced in the legislation?

Ms. **Douglas**. Yes. In terms of specific agencies, I do not believe so at this time. I think that the other changes that are included in S. 1458 will help overcome some of the agencies' resistance or in some cases overcome almost the court imprimatur for false certifications, which is an important point.

It has always been my contention that the really important part of this bill is the enforcement provisions, that the bill in every other section is written beautifully; that it is a good piece of work, but without a strong enforcement provision, there is literally nothing that can be done.

I will admit, for example, that NFIB has done a lousy job over the years in terms of overseeing what the agencies are doing in implementing this act. Virtually, it is an impossible task. Frank Swain and his shop have done an admirable task with an overwhelming burden; that is, one office with very few people overseeing 90-odd agencies.

I think that any way that we can strengthen judicial review, without wanting to clog the courts unnecessarily or necessarily impede the rulemaking process except in those instances where it should be impeded—that is the crux of the problem that we have with Regulatory Flexibility and judicial review.

We set it up so that judicial review would not apply solely to Regulatory Flexibility. I am not sure that I agree with that decision. I can see practically why it had to be that way. I think that if we try to overstrengthen the judicial review, as an example, if we try to actually allow judicial review of the Regulatory Flexibility analysis not as part of the rule but just in and of itself, that we would probably get overwhelming resistance from all corners. On the other hand, it may be something we might want to consider.

My fear is that even with taking care of the certification problem, it still requires an awful lot of oversight, it still requires people who are willing to bring cases, and because it hinges on the rule in its entirety, unless there is something else that is faulty, you cannot bring the case to court. That could be a significant problem still.

Senator WALLOP. Let me just ask in line with that, is there some thought that any of you have given that we might be able to create not an office of advocacy but a representative office within the Small Business Administration that might be able to pursue some of these issues on behalf of related small businesses throughout the country? I hate to use this word because it has sort of other implications, but could they be sort of an ombudsman that joins the agencies into responsible action with effective segments of the small business community?

Ms. DOUGLAS. There have been two different approaches looked at. One was to try and increase the accountability of those people within each agency who have the responsibility for performing the analysis. Obviously, the bill was written in such a way that ultimate accountability was supposed to go right to the top. That has not exactly occurred the way we would like to have seen it.

I hate to say this but, of course, you are used to hearing this in these times of budgetary constraints. I am not sure that we will be able to get another office in SBA. I think it might be nice to be able to beef up the Office of Advocacy staff in the existing office. They have the record. There are people in there who have been there from the beginning, who understand this act, who understand the purposes. That may be an alternative approach rather than another, separate office.

I think it also, frankly, takes a little bit more commitment on the part of OMB working with SBA. Frank has mentioned that in several instances they were able to stop a rule or slow down the rulemaking process with OMB's help, and I think that is critical. I do not know exactly how you do that, how you institutionalize that, but that obviously is going to hold some sway in terms of how well the agencies comply with this and how strictly it can be enforced.

Senator KASTEN. I want to just pursue that one more step. Do we find ourselves in the position where Frank Swain's office, the Office of Advocacy, says that something should qualify under the Regulatory Flexibility Act and then the Agency says no, this is an interpretive rule or no, this does not qualify for some other kind of reason, and we do not have at this time judicial review. Or does the Small Business Advocacy Office not address this issue in any kind of a policy meeting?

What happens? Does the Advocacy Office raise the point that a proposed regulation should be subject to the Regulatory Flexibility Act and then they are told, "no, it is not?"

Has Frank Swain covered this? We both missed his testimony because we were down at a meeting at the White House.

Ms. DOUGLAS. Essentially, Frank has review powers under the act. He is also the recognized person who has standing in the court in terms of a court case; but aside from those two things, it is my understanding that his office really has no power to insist. He does not have a veto power over this. He has the power to review, simply and purely.

OMB is the only Agency that has the legal power to actually stop a rule or slow it down or force an agency to take another hard look. There is no such power in the Regulatory Flexibility Act for the Office of Advocacy.

Senator KASTEN. Thank you, Mr. Chairman.

Senator WALLOP. I might just observe that everybody makes a certain amount of sacrifice to come to a hearing like this, time away from their business, their jobs. John, having given up his elk hunting trip, has gone the ultimate mile for somebody from Wyoming, and I appreciate it. [Laughter.]

Mr. VANDEL. Well, Senator, I appreciate that. I think that the quality of life up on that hill is a little nicer than it is back here, but I think this is well worth the effort.

Senator WALLOP. Let me ask you, other than HCFA, have you had any specific problems with other agencies such as the Food & Drug Administration as far as compliance with Regulatory Flexibility?

Mr. VANDEL. Not to my knowledge. I have not personally. Of course, I am not back here where a lot of it is happening.

Most of the time with Food & Drug we are able to work with the Food and Drug Administration. I assume there are things that we have questions about but nothing at this time specifically comes to mind. Let me refer to my counsel if I could here.

There have been areas where we have had some concerns about the Federal Trade Commission stepping in when we questioned their wisdom in entering.

Senator WALLOP. How do you find out about regulations that might adversely impact your business in a rural State like Wyoming? Does the trade association——

Mr. VANDEL. The trade associations are exactly where we find out.

Senator **Wallop** [continuing]. Just find out when they come visiting and say you are not in the plans?

Mr. **Vandel**. No. Our trade association sensitizes to the problems, sends us copies of the record, and gives us case studies to look at as to what might happen, they try to help us as much as they can.

There are a lot of people out there that, for one reason or another, do not understand or do not belong to the trade association, and when someone knocks on their door, it gets their immediate attention.

Senator **Wallop**. It is a challenge to be in a small business anyway, and when you have a Government that is insensitive to it even though it is the basic backbone of American employment, it seems like this kind of thing is important to us.

Dr. Cahilly, instead of attempting in the early days to meet the requirements of Section 89, did it ever cross your mind it would be less costly to drop employee health care coverage and raise their salary a certain percentage to help them out and just sort of let the rules go?

Dr. **Cahilly**. Honestly, no.

Senator **Wallop**. Do you know of any companies who did weigh that and perhaps chose that road?

Dr. **Cahilly**. I have read about companies that have done that, but I do not personally know any of them.

Senator **Wallop**. In your testimony you make reference to preparing a cost-benefit standard prior to enactment of legislation. In my statement earlier that was entered into the record, I indicated sponsorship of such a bill but it only applies to legislation requiring new employee benefits.

Do you think that this requirement should be expanded to most legislation in order to assist the regulatory agencies in complying with Regulatory Flexibility?

Dr. **Cahilly**. I am not sure I follow you.

Senator **Wallop**. You talked about establishing a cost-benefits standard prior to the enactment of legislation. I have such a bill with quite a few co-sponsors, but it only applies to new employee benefits, and the effects of those.

My question is, should that concept be expanded?

Dr. **Cahilly**. Absolutely.

Senator **Wallop**. If so, in what areas of legislation prior to enactment?

It is easy to know about the employee benefits, daycare, expanded health care requirements, any of those.

Dr. **Cahilly**. One of the agencies that impacts us directly is the EPA. We are in a situation where, because there is not a nationally approved accreditation program for laboratories of our type in the environmental business, the EPA, by default, ends up being a de facto or an ex officio type of accrediting body.

They have a thing called the CLP—Contract Laboratory Program—which is designed to make certain that the laboratory that generates critical data—such as data that might be involved in a Superfund cleanup site or data where the legal consequences are pretty severe—provides the data with backup proving that it did the analytical work according to the best recommended protocol.

These CLP packages can involve perhaps 1 page of analytical data, perhaps only one number, for example, a number that might reflect how much lead or how much of some other contaminant is in the environment. But that one number might have to be backed up by as many as 300- to 1,000-pages of documentation showing that the laboratory satisfied the quality requirements.

The cost-benefit ratio here is insanely out of balance.

Senator **Wallop**. It is interesting that you bring up EPA. I think the same thing is true, John, in my State and most of our States in the rural areas with regard to the leaking underground storage tanks. Had anybody made a review of that, there would have been ways to achieve the environmental goals of it without putting 70 percent of the strictly rural gas stations out of business.

Ms. Douglas, to your knowledge have any of your members been forced out of business due to the anticipated costs or even the actual costs of compliance with Section 89?

Ms. **Douglas**. Forced out of business or giving up their health plan?

Senator **Wallop**. Either.

Ms. **Douglas**. I know of no one who has been forced out of business because, unfortunately, when they go out of business they are no longer members of NFIB, and it is a little hard to track them.

We have had numerous letters and phone calls from people who have conducted similar reviews, as the good doctor here, and have determined that it would be a good deal cheaper for them to drop their health plans. In fact, I just had a letter from a gentleman in Pennsylvania yesterday who was talking about the significant premium increases that he has already had in his health plan, and then putting Section 89 on top of that, he has had to cut back seriously on his plan without completely eliminating it, to the tune of about a $171,000 cost increase in a year's time for him, for his company.

So yes, I would assume there are probably a number of firms who have either dropped plans or anticipate dropping them unless Section 89 is repealed, which we know will happen.

Senator **Wallop**. As these other mandated benefit packages come down, it is clear that that kind of review is a requirement priority.

Mr. **Vandel**. Senator Wallop, I think that the main problem we have in small business today in most sectors is there is just not that much net profit left, and it does not take much to just trip you over the edge into nonprofitability. It is a continual fight that is going on, day after day, out there.

Senator **Wallop**. It is hard enough to fight the business requirements without having to fight your Government, too.

Senator Harkin, did you have any questions?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Harkin**. No, Mr. Chairman.

Senator **Wallop**. Well, thank you all very much for your presence here. John, a special thank you.

Mr. **Vandel**. Thank you.

Senator **Wallop**. The next panel is panel No. 4: Mr. John Satagaj, president of the Small Business Legislative Council; and Bernard Browning, president of General Business Services, Germantown, MD. He is representing National Small Business United.

Gentlemen, welcome.

Mr. Satagaj.

STATEMENT OF JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL, WASHINGTON, DC

Mr. **Satagaj**. Thank you, Senator.

First, I want to thank you for holding this hearing. This is not a hearing that is going to get you any headlines, but it is one that is certainly very serious and important to us.

On the subject of not garnering headlines and doing the drudgery work, this is also a good time to compliment Senator Kasten, because in the last couple of months there has been a lot of activity on the floor and the Senator has been doing yeoman work for us. I do want to take this opportunity to recognize his efforts. It has been kind of tough lately, and we appreciate his efforts in particular.

Second, no one can accuse us today, of being irrational players and shooting from the hip on the subject of Regulatory Flexibility. We have now put the better part of a decade behind us. Just as we did in the last Congress with Prompt Pay, this is a good time to reflect on the accomplishments and the deficiencies of the Regulatory Flexibility Act.

What I would like to do today is answer the real question, does the Regulatory Flexibility Act work? The answer is a resounding yes and no.

Reasons for the yes: First, through this process of working for and under this law, small business has gained credibility. In the last decade, we spent a lot of time and effort not only institutionalizing the process of considering small business, but also of making our point on the substantive matters. Through this law we have gained credibility.

Second, small business did not and does not have the resources itself to conduct an analysis of the impact of public policy on small business.

Part of the thinking at the time when we created the Office of Advocacy and at the time of the passage of the Regulatory Flexibility Act was to at least produce the raw analysis; use the agencies themselves to produce the data because, after all, who knew the constituency better than the agency regulating the constituency? Use that agency, produce the analysis, then use the check and balance of the Office of Advocacy to make sure that we are not manipulating the analysis. The law has produced a lot of good analysis over the last decade.

The truth of the matter is, if it is left up to those of us in the private sector, or National Small Business United or NFIB or the chamber, we still cannot produce the analysis. We are a little better at it than we were 10 years ago, but we are not there yet. Regulatory Flexibility helps us produce the analyses.

Third, it highlights issues. It is very difficult for your druggist in Wyoming to find out about issues, and his trade association does a very good job. The truth of the matter is, however, that without agencies themselves telling us about some of these issues, we would never find them. If you look through the record of all the analysis done in the last decade, there are areas where I would never even think of looking, if it were not for Regulatory Flexibility. It has been a very big plus.

Finally, the RFA does give us an avenue into the agencies. They have to put something out there. Either they certify that the rule does not affect small business, or they do the analysis and say there is no impact, but one way or another it creates an avenue for us. As a result, we have a way to walk in the door and begin the conversation, and without Regulatory Flexibility we would not have that.

Now on the "no" side of the equation, the reason for the "no" is a very simple one. Regulatory Flexibility has no teeth. We need judicial review. There is just no two ways around it. Without the meaningful judicial review, compliance with the RFA is just another step in a cookbook. After you get the system down, whether you are a bureaucrat or small business, you figure out what you have to do, the minimum necessary to get by.

Basically, that is what has happened with Regulatory Flexibility. The agencies have now figured out, "OK, this is what I have to do to get by, and that is all I am going to do" and there is no way to force them to do otherwise.

The Senator asked a question about advocacy, I believe, about whether they can go back and challenge a decision if somebody says there is no impact and provides certification to that effect. I do know for a fact that is what advocacy does do. They will say, "Listen, you said there is no impact here and you are certifying it. We do not believe that is the case." The problem is, that is the end of it. Nothing happens after that point.

So advocacy is doing its job. It is challenging the regulations even at the earliest point, but nothing happens beyond that when they do challenge the decision and that is when judicial review will help us.

Now right away somebody is going to say, "Listen, this is going to throw the whole system in chaos, the walls are tumbling down." I think there are two responses to that concern.

First of all, one of the nice things about Regulatory Flexibility is that it has been here now for the better part of a decade. The walls are not going to come tumbling down. Judicial review is an incremental step. Give us a little more. After all, we have the Administrative Procedures Act already, and we already have reviews. This is just taking it to the next step.

Let us be pessimistic about it and say there is chaos. I would say fine. Let us handle the chaos for a while. We will end up with a better system. I am sure when we started talking about environmental impact statements the same response was heard in the halls of Congress, that this is going to cause a problem. I think most people live with the environmental impact statements now, and in most cases they do a good job of presenting the issues. We survived, and I think we could survive judicial review of Regulatory Flexibility.

We talked a lot today about where the regulatory process takes place, and I think you know better than us that it is now happening in Congress. We have basically pushed the micromanagement of business upstream. I know it probably is not practical, unfortunately, but your proposal to require the statements on employee benefits is exactly what we need. We need to conduct that analysis at the earliest possible point in the regulatory process, and now that is in Congress. We should be doing it here. Frankly, that is where we spend all our time.

Sally Douglas talked about the fact that her organization does not spend as much time looking at the agencies under Regulatory Flexibility. I would say we are in the same boat. We do not do it anymore because all our resources are spent up here. We are spending all our time just dealing with the legislative process.

We would be a very strong proponent of getting that system in place in Congress. Let us take a realistic view of the world before we start passing these bills, and then we will not have a section 89. We will stop those things.

I might add two points before I get to the bottom line. One is, as has been mentioned several times today, the interpretive regulations of Treasury. Up until 3 years ago, if you took a survey of small business, consistently the one Agency that always came to the top of the list was Treasury. In the last 3 years it has probably dropped a little bit because we have been spending so much time in the employee benefits area. In fact, part of that problem is with Treasury.

The truth of the matter is if you want to get a small business group going, just talk about Treasury a little while, and you will get them excited. You have to deal with the interpretive rules.

Second, there are some problems with the definitions of how agencies define small business and the dominance in an industry. A good example with which I am sure you are familiar is the rural telephone companies. In many cases, the FCC automatically decides where the rural telephone company dominates the area and is the provider of the service, they say Regulatory Flexibility does not apply.

Now compared to any one of the regional Bells, for example, those rural telephone companies do in fact shoulder a substantial disproportionate burden compared to some of the larger urban giants we have in the telephone industry, but the FCC automatically dismisses it. So we need to clean that up a little bit as to what we mean about small business. If you are a small telephone company, you have the right to protection under this law just like any other small business.

In summary, we believe that RFA has played a meaningful role in establishing our credibility and providing the analysis, but the truth is in this area of micromanagement it needs respect, and you spell respect "judicial review".

Thank you, Mr. Chairman.

[The prepared statement of Mr. Satagaj follows:]

Small
Business
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STATEMENT OF

John S. Satagaj, President

of the

Small Business Legislative Council

Before the

Senate Committee on Small Business

on the subject of

the Regulatory Flexibility Act

October 17, 1989

On behalf of the Small Business Legislative Council (SBLC) we appreciate the opportunity to present our views on the Regulatory Flexibility Act (RFA).

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of over four million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. Our policy is developed through consensus among our membership, and we respect the right of individual associations to express their own views. For your information, a list of our members is enclosed.

In a departure from our customary procedure, I am testifying today, wearing two hats. I do so because I think understanding the nature of my two hats is helpful to this discussion. I am here today in my capacity as President of SBLC, but I also bring to the table my past experience. I had the privilege of serving in the Office of Advocacy during the original consideration of RFA, the 1980 White House conference on Small Business, and the early days of implementation of the Act. A significant portion of my time during my tenure with Advocacy was devoted to the passage and the implementation of the RFA. I did have a ring side seat and therefore believe I can offer views of the achievements of RFA from a historical perspective.

In that vein, I am frequently asked what is the difference between 1978-80 and 1985-86 in the priorities of small business. (These periods roughly correspond to the two White House Conferences on Small Business). The short answer is that in the late 1970's and early 1980's our focus was institutionalizing the small business role in public policy making, and in

1985-1986, and yet today, our focus is on shaping the substantive elements of public policy to reflect the needs and concerns of small business.

A decade ago, Advocacy was in its infancy, and in relatively quick succession, the Paperwork Reduction Act, RFA, the Equal Access to Justice Act, the Prompt Pay Act and the Small Business Innovative Research Act were enacted. From the creation of the Office of Advocacy through the passage of those laws, the clear theme was how do we ensure that when government undertakes an action, it has considered the impact upon small business and how can we, the small business community, ensure we have input into the process. In some sense, it was a great sensitivity experiment and the federal government was the patient.

The patient did survive, and while RFA was not a cure, it did offer relief. Now that we have entered a period of extraordinary congressional micromanagement of business through social, economical and environmental concerns, the question is whether the Regulatory Flexibility Act remains any help to us. The answer is a clear yes and no.

The "yes" is derived from two measures of success. Through the process of working for, and under this law, small business has gained credibility. Small business does not have the resources itself to conduct an analysis of the impact of public policy on small business. Part of the thinking at the time, behind the creation of the Office of Advocacy and passage of the RFA, was to at least produce the raw analysis, using the regulator's own resources, and using the check and balance of Advocacy, to ensure the analysis was not manipulated. The truth is, we still are unable to conduct the independent quality analysis we would like to see, but the RFA has been successful in fulfilling that portion of its mission.

The "no" reflects the fact the process of compliance with the RFA has become a mechanical one. The agencies do not have their hearts behind compliance. For the most part, they are going through the motions. If RFA continues to give us some edge, it is because it highlights some issues that we would otherwise miss. It also does give small business an avenue to approach agencies, and we cannot by dismissed out of hand by the agencies.

The problem quite simply is the RFA does not have teeth. With no meaningful judicial review, its just another step in the cook book for regulators. Add judicial review and the RFA will be given the attention it deserves. The moral of the story is that just ordering bureaucrats to be sensitive to small business is not enough. I am sure some will argue that judicial review will throw the system in chaos. Each rule is already subject to review under the Administrative Procedures Act - the underpinnings of the whole administrative law system - and no chaos results; all we are asking is to add another dimensional court review. Even if there is some initial confusion, it will not be the first time. We have survived previous disruptions and are better for it. I believe the world has adjusted to environmental impact statements, and I am equally certain a similar hue and cry was sounded when EISs were proposed. Let us risk the short term difficulties for the long term benefit to the economy.

In our view, the regulatory process has swum upstream and now resides in Congress. Section 89, plant closing notifications, auto-log rules, underground storage tank rules, and I-9 forms are just a few examples of congressional micromanagement. More regulation such as parental leave, mandated health insurance, high risk occupational disease notification are waiting in the congressional wings.

The irony is that complicated regulatory requirements create an underground community of owners who say: "This is just too difficult, I'll take my chances and wait to see if they catch me." We do not want that to happen and we believe most small business owners do not want it to happen. Experience shows that everyone, including small business, is more likely to comply with rules if they know why the rules are being imposed, feel confident that the regulatory scheme chosen was the most reasonable, and know what they have to do.

The way to ensure compliance is to be realistic and flexible in the development of laws and regulation. Is that not why this Committee was instrumental in the passage of the Regulatory Flexibility Act? We believe it is time Congress applied the Regulatory Flexibility Act to itself. Specifically, we believe it is time for Congress to require standing committees to undertake a careful economic impact of proposed legislation upon small business before the committee votes on legislation. In the last Congress, the chairman of this committee proposed, and the Senate adopted, a proposal to do just that. We submit that if Congress undertook the economic analysis of the type required by the Regulatory Flexibility Act, there would not be any Section 89's.

I might add, if we had a strong RFA with judicial review, it might create more confidence in the regulatory system and we could spend less time, and less of our scarce resources, lobbying Congress.

Before I conclude my remarks, I would be remiss if I didn't state our belief that Treasury interpretative regulations should be subject to the Act. If there is any agency that should be included, it should be the IRS. Its impact upon small business may be more significant than that of all other agencies combined.

In summary, we believe the RFA has played a meaningful role in establishing the credibility of small business. If it is to make a difference in this new era of micromanagement, it needs respect and respect is spelled judicial review.

Thank you.

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Attachment

SMALL BUSINESS
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COUNCIL

Members of the Small Business Legislative Council

Air Conditioning Contractors of America
Alliance of Independent Store Owners and Professionals
American Animal Hospital Association
American Association of Nurserymen
American Collectors Association, Inc.
American Consulting Engineers Council
American Council of Independent Laboratories
American Dental Trade Association
American Floorcovering Association
American Institute of Architects
American Machine Tool Distributors Association
American Road & Transportation Builders Association
American Society of Travel Agents, Inc.
American Sod Producers Association
American Subcontractors Association
American Textile Machinery Association
American Trucking Associations, Inc.
American Warehousemen's Association
Architectural Precast Association
Associated Builders & Contractors
Associated Equipment Distributors
Associated Landscape Contractors of America
Association of Physical Fitness Centers
Association of Small Business Development Centers
Association of the Wall and Ceiling Industries-International
Automotive Service Association
Bowling Proprietors Association of America
Building Service Contractors Association International
Business Advertising Council
Christian Booksellers Association
Council of Fleet Specialists
Electronics Representatives Association
Florists' Transworld Delivery Association
Helicopter Association International
Independent Bakers Association
Independent Bankers Association of America
Independent Medical Distributors Association
International Association of Refrigerated Warehouses
International Bottled Water Association
International Communications Industries Association
International Franchise Association
Latin American Manufacturers Association
Machinery Dealers National Association
Manufacturers Agents National Association
Mechanical Contractors Association of America, Inc.
Menswear Retailers of America
NMTBA-The Association for Manufacturing Technology
National Asphalt Pavement Association
National Association for the Self-Employed
National Association of Brick Distributors
National Association of Catalog Showroom Merchandisers
National Association of Chemical Distributors
National Association of Development Companies
National Association of Home Builders
National Association of Investment Companies
National Association of Manufacturing Opticians
National Association of Passenger Vessel Owners
National Association of Personnel Consultants
National Association of Plumbing-Heating-Cooling Contractors
National Association of Realtors®
National Association of Retail Druggists
National Association of Small Business Investment Companies
National Association of the Remodeling Industry
National Association of Truck Stop Operators
National Association of Women Business Owners
National Campground Owners Association
National Candy Wholesalers Association
National Chimney Sweep Guild
National Coffee Service Association
National Council for Industrial Innovation
National Electrical Contractors Association
National Fastener Distributors Association
National Grocers Association
National Independent Dairy-Foods Association
National Knitwear & Sportswear Association
National Lumber & Building Material Dealers Association
National Moving and Storage Association
National Office Products Association
National Paperbox & Packaging Association
National Parking Association
National Precast Concrete Association
National Shoe Retailers Association
National Society of Public Accountants
National Tire Dealers & Retreaders Association
National Tooling and Machining Association
National Tour Association
National Venture Capital Association
Opticians Association of America
Organization for the Protection and Advancement of Small Telephone Companies
Petroleum Marketers Association of America
Printing Industries of America, Inc.
Professional Plant Growers Association
Retail Bakers of America
SMC/Pennsylvania Small Business
Small Business Council of America, Inc.
Society of American Florists
Specialty Advertising Association International
United Bus Owners of America

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Senator WALLOP. Thank you, Mr. Satagaj.

Mr. Browning, we will hear from you.

STATEMENT OF BERNARD S. BROWNING, CHAIRMAN, GENERAL BUSINESS SERVICES, INC., GERMANTOWN, MD, ON BEHALF OF NATIONAL SMALL BUSINESS UNITED

Mr. BROWNING. Mr. Chairman, I guess in this World Series season I am your clean-up hitter. I am Bernard Browning, chairman of General Business Services, Inc., and I am pleased to represent this morning National Small Business United. You have our prepared statement, and with the Chairman's permission I would like to have that inserted in the record.

Senator WALLOP. By all means.

Mr. BROWNING. I have sat through all of the testimony here this morning, and everyone is so unanimous that I hope your bill goes through with a huge majority because I find nothing I disagree with. I support everything that the previous witnesses have provided to you.

There are three points that I would like to make that may be helpful to you in your consideration. Our company, General Business Services, Inc., has been helping small business for the last 27 years, and that total is now over 200,000 different businesses. I would dare say that in that period of time almost all of those 200,000-plus businesses have needed help in the compliance arena.

The thing that I would hope that somehow you can get across to all of your colleagues on the Hill is that there are millions of small businesses out there that are not represented, who do not know about these hearings, who cannot be here. While all of us are proud as members of associations to come and speak on their behalf, the unfortunate part is most of them do not belong, and they are not here.

If you can somehow get across to the Members of the Congress the fact that it is really your responsibility to protect those millions of small businesses out there that do not know about these regulations until it is too late. I hope that due to lack of comments or letters from the small business community that no Member of Congress will misunderstand as being lack of interest or concern.

The second point which I would urge you to consider and I know that you do from your earlier comments, is that the regulators in this town are experienced in paperwork; but unfortunately, few, if any, seem to have ever had any experience in operating a small business, so they are in a totally different world. They just absolutely do not comprehend. What may appear to them to be a very simple task in compliance may take hours for the inexperienced person who is unfamiliar with it.

For the person who arrogantly feels there is nothing to this, I would suggest they measure the time it takes to put together a toy on Christmas Eve following the instructions. Something that probably should take 10 minutes if you could do it frequently, your first time around you spend 1½ hours in frustration and often go back to the store and tell them it is wrong, but it is your lack of knowledge.

Senator **Wallop**. Only to see the child play with the box it came in. [Laughter.]

Mr. **Browning**. The thing in this regard that so often I find the regulators talk about in compliance is completing the form. They do not think about the hours that are spent compiling the data to put on the form. This is the thing that I think our friends at IRS and other places so often forget. These are hours that the small business person utilizes that I contend are totally wasteful. They are not productive. They add to the overhead. These costs pass on to the consumer.

That brings me to my third point that I think is often overlooked, and that is the fact that our competitiveness as a country is at stake, and consumers end up paying higher prices because for every overhead expense the customer somehow has to pay the bill. It goes in there despite all the protests otherwise.

So any simple product, whether it be this microphone or desk or what have you, there are hundreds of businesses that are involved in bringing that final item to the marketplace, and if every business has a certain percentage of added overhead it adds up to the total cost. Compliance is an area that just simply does not make savings for the consumer. We hear much about America being competitive in the world market, and one way we can start is right here.

I trust, Mr. Chairman, that your bill will be passed with great support, and I thank you again for the opportunity to come here and to speak on behalf of National Small Business United and the other 18 million small businesses.

[The prepared statement of Mr. Browning follows:]

NATIONAL SMALL BUSINESS UNITED

"Serving America's small businesses since 1937"

Statement
of
Bernard S. Browning

on behalf of
National Small Business United

before the
U.S. Senate Committee on Small Business

regarding
the Regulatory Flexibility Act

October 17, 1989

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Mr. Chairman and Members of the Committee:

Good Morning. My name is Bernard Browning, and I am the founder and president of General Business Services of Germantown, Maryland. I also serve on the Board of Directors of National Small Business United, of which I am a past Chairman. I am proud to be representing NSBU at today's important hearing. I would first like to take this opportunity to thank the committee for holding this hearing and for being so helpful in the continuing search for solutions to all manner of small business problems.

As you may well know, National Small Business United (NSBU) is the oldest association exclusively serving the small business community of our nation--for over 50 years now. NSBU serves over 50,000 individual companies with members in each of the 50 states, as well as local, state, and regional organizations. NSBU is uniquely qualified to represent the views of the small business person.

I am pleased to be here today to testify on the status of the Regulatory Flexibility Act, as well as to comment on a new bill, S.1458, introduced by Senator Wallop to strengthen the Act and help small business in a number of ways. Senator Wallop's bill will do several important things. It will 1) require interpretive rules to be subject to the Act, thereby unquestionably bringing the IRS under its auspices; 2) take into account the indirect effects of regulation on small business; and 3) it will allow greater judicial review of the agency's decisions. These are all very important steps very helpful to small businesses, and we heartily endorse them.

First, some background. After being a top recommendation of the first White House Conference on Small Business, the Regulatory Flexibility Act became an important policy-making tool for regulators at the federal level because of the realization that small and large businesses function differently; so, regulations that treat them the same are therefore discriminatory. Since this time, the Act has become an important model used by state governments as well.

All too often in the past, government had ignored these differences between large and small businesses. With passage of the Regulatory Flexibility Act, Congress firmly established the principle that small businesses are unique, and that regulators would no longer pass rules and regulations without considering the effect on smaller businesses and considering less burdensome alternatives.

The Regulatory Flexibility Act requires regulators to account for the small business costs of their actions. Although not without its problems and areas for improvement, these first years of implementation of the Regulatory Flexibility Act (RFA) have proven its value to the small business community. As I shall attempt to point out, however, areas of concern remain, particularly with respect to the areas of the IRS, procurement, and paperwork reduction.

The RFA requires every agency to perform an Initial Regulatory Flexibility Analysis (IRFA) for each regulation deemed to have a significant impact on small business. These IRFAs must first contain estimates both of how many small businesses would be affected and descriptions of their regulatory requirements, including special skills which might be necessary to fulfill those requirements. The IRFAs must then also discuss alternatives and their feasibility.

The obvious flaws in this process, which have led to problems in the past, are that it is the agency's responsibility to decide whether the rule has a significant impact on small business (good or bad) and to perform the IRFA to determine the extent of that impact. The conclusions of the agencies regarding these matters are not always thoughtful and well documented (though they often are); hence, the quality utilization and recognition of the intent of the RFA is sporadic. The Act also does not provide any judicial review and recourse for a situation when the regulator has ruled that there is not a significant impact on small business. Senator Wallop's bill would change this scenario by allowing for judicial review and challenges to an agency's proclamations concerning the impact on small business. It is true that over the years since original implementation, the Act has become a more ingrained process for the regulators and their commitment to it has grown. But, it should be clear that--especially without appropriate judicial review--the levels of implementation for the Act are only as high as the quality of work performed by the regulators.

It is surely the case that no set of regulations affect small businesses more than those found in the Internal Revenue Code. Yet, largely by self-proclamation, the IRS is--for all practical purposes--exempt from the requirements of the RFA. Interpretive decisions (those intended simply to implement a statute when Congress has not delegated any real authority to the agency) are not impacted by the Act. The IRS, therefore claims that its "interpretive" rules (most of its rules) are beyond the reach of the RFA.

It has long been the position of NSBU that the IRS should be placed fully under the scope of the Regulatory Flexibility Act. Senator Wallop's bill would do so. S.1458 would require agencies--including the IRS--to perform IRFAs on interpretive rules as well. Simply because a ruling is interpretive in nature and is following Congressional intent does not mean that an alternative rule, more favorable and workable for small business, is not possible. Furthermore, even in instances where the IRS has little latitude from Congress to formulate an alternative rule, an analysis could be very useful to legislators to realize the problems for future decisions.

Through the years there has also been a lack of cooperation with the Act from rulemakers responsible for procurement rules. Since the federal government now spends well over $200 billion per year in the private procurement market, any discrimination against small business during the promulgation of these rules can readily be seen as a major problem. The SBA's Office of Advocacy originally reported problems with procurement rulemaking in its 1986 annual report. Although compliance seems to have strengthened since that time, there may still be a need to allow the Office of Advocacy greater authority to review rules and enforce the provisions of the Act.

The Regulatory Flexibility Act, as currently written and--more importantly--as currently interpreted does very little to reduce the small business paperwork burden. The Act requires federal agencies to consider the paperwork and reporting requirements on small business of a regulation, in addition to the more substantive impacts a regulation may have. However, there is sparse evidence the many agencies ever take this charge into consideration.

Rather than considering the paperwork burden themselves, agencies tend to rely on the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB) for analyses of paperwork burdens. Under another law (The Paperwork Reduction Act), OIRA is required to centrally review all regulations to be sure that they meet certain information collection requirements. Relying on OIRA for all paperwork analyses, it has been rare that an agency has adopted a paperwork system with a separate simplified approach for small businesses. Instead, these agencies have tended to adopt a uniform and unsubstantiated statement that no simpler (and practicable) means exists to collect data from small business. An appropriate investigation--in lieu of a perfunctory statement--from these agencies would be very helpful for them to determine if this alternative may exist; it would also be very helpful to OMB and OIRA as they set about the lonely task of developing appropriate paperwork burdens for all regulations.

After these years of seeing the Act in implementation, it has become clear that it should be expanded in one more significant way. As currently written, the Regulatory Flexibility Act only affects those regulations which have a direct impact on small businesses. Very often, however, some of the most devastating regulations are ones which affect businesses indirectly. For example, regulations on insurance companies and health care providers could very well impact the bottom line (either positively or negatively) of small businesses attempting to purchase and maintain health insurance. That "indirect" impact on small businesses of such regulations, not specifically written for their compliance, should enter into the impact analysis of the regulators. Senator Wallop's bill would require such considerations, which would be a big step forward in the struggle against the adverse impact of government on small business.

The Regulatory Flexibility Act has been an important tool for keeping the burdens of regulatory whimsy and misunderstanding from overly impacting small business. Under the Act, the federal regulatory process has evolved far beyond the frequent ill-consideration of previous years. Yet, more still needs to be done. The guiding principles behind the Act are well defined; the problem remains in perfecting our tool for carrying out those principles. Senator Wallop's bill, S.1458, is an important step in that direction. We heartily endorse S.1458 and urge its speedy adoption.

National Small Business United appreciates the opportunity to testify before the Committee today. We also wish to thank the Committee for holding this hearing on a matter of such importance to small business. Finally, we also wish to congratulate Senator Wallop for introducing this fine reform bill. As this issue remains before the country, and as S.1458 moves its way through Congress, we stand ready to help in any way we can.

Senator **Wallop**. Mr. Browning, thank you for your testimony.

Let me make an observation which is not meant as criticism but just as reality. You made the statement that you hope Members of Congress would not view lack of comment as lack of concern because so many small businesses that simply do not know things are happening and do not belong to trade associations.

One of the big problems in Congress is too few people in Congress have ever been in business, so a lack of comment does not necessarily mean a lack of concern but just a lack of knowledge as to how things affect you in a small operation which is surrounded by big Government and big competition trying to squeak a living out from under all of these things.

I do not know what the answer to that is except that members of the small business community who are busy making a living for their family may have to start at sometime or another sacrificing a little bit and come here for a few years. I do not recommend it as joy, but I recommend it as necessity.

Mr. **Satagaj**. One of my mentors is the first Chief Counsel for Advocacy, a guy named Milt Stewart. He had the theory that we should have small business a day in our district. We would send every Member of Congress and every member of their staff for a day to work in a small business just to get an idea of what it is like. He sent all of us when we used to work in his office. We all had to go out at least 1 day just to get an idea of how a small businessowner makes a decision.

If somebody saw, for example, in a small business the decisions that are necessary just to select a health insurance package, they would appreciate what Section 89 was all about. Clearly, they did not understand the decision process in a small business.

You are right, actually, in what you are saying, but on the other side it would be nice if I could get everybody out there to at least see for 1 day what a small business is really like.

Senator **Wallop**. The key is not to pick up the garbage cans and to make the sodas at the soda fountain. The key is to go to the office where those things confound the life of an average small businessman.

Mr. **Satagaj**. Exactly.

Senator **Kasten**. John, you mentioned the fact that the Small Business Office of Advocacy challenges some of these rules. Where do they challenge these rules? At OMB in some kind of a council that is joined together?

OMB could be an enforcer, and if OMB was doing this right, this legislation might not be necessary, in my view. I think that this legislation is necessary because that challenge, wherever it is, is not working and, clearly, the bureaucrats at OMB seem to be taking the point of view of the IRS or whichever Agency it might be.

Where is this challenge taking place now?

Mr. **Satagaj**. It is directly to the Agency. You are probably right. The interesting thing about putting it in OMB is that right now we are also fighting a battle with the Paperwork Reduction Act, and one of the criticisms in that case is that OMB is strangling the regulatory process because they do a darn good job of what you are suggesting they should do. Maybe OMB could be the enforcer.

We are already getting criticism from other sectors that OMB is doing too good a job in that area. The answer to your question is probably yes, we might be able to improve the process by getting OMB involved.

The response to your question is that I believe the advocacy goes directly to the agency involved. OMB, itself, is not involved in the process.

Senator KASTEN. So the Small Business Administration's Office of Advocacy goes to Treasury and says that we believe this law impacts small businesses, and then Treasury makes the decision that this is really an interpretive rule?

Mr. SATAGAJ. Right.

Senator KASTEN. Then there is no recourse?

Mr. SATAGAJ. That is the end of it there, basically.

Senator KASTEN. Does that happen?

Mr. SATAGAJ. Obviously, Frank Swain would be in a better position to answer that question, but that is basically my understanding of it. I am sure that Frank calls these things to the attention of OMB, but there is no formal role for OMB in the process, so it just goes back and forth between advocacy and the agency and it dies.

Senator WALLOP. Would you care to comment on that?

Mr. BROWNING. I think that Frank Swain in his testimony mentioned that and the great need for judicial review involvement. It has no teeth at present. If the regulator had to go and satisfy such a requirement, then that might do it.

Mr. SATAGAJ. Frank has to be given a lot of credit. It amounts to jawboning at that point with the agency, whoever it is, and to the extent he is able to jawbone, he is successful in moving them. That is all it is. It is the talent of the individual in that office more than it is the law.

Senator KASTEN. I think it is important that we assume the agency is not going to be responsive; therefore, we have to give the Regulatory Flexibility Act the teeth that you have both described so that it really does make a difference.

If you just walk over there and ask them to do you a favor by saying that this fits under the Regulatory Flexibility Act, they, generally speaking, are not going to do it because they simply do not believe in the overall direction of the act in the beginning.

Mr. SATAGAJ. Right. I agree 100 percent.

Mr. BROWNING. When you have people who first-off are not sympathetic, and it may be just their lack of experience, and put them in a situation even with the best intentions, there will be so many things they will overlook. Then when you add that, it complicates it so the need grows in geometric progression.

Senator KASTEN. Then you combine those with the revenue estimators, and you are really in trouble.

Thank you, Mr. Chairman.

Senator WALLOP. Along that line, I think you both mentioned the indirect regulatory impacts are often more burdensome than the direct ones. Some contend that the requirements in my bill to take into consideration indirect regulatory is too burdensome for the regulators, carrying out possible implications for small businesses to sort of ridiculous lengths.

Do you agree with that as a possibility?

Mr. **BROWNING.** No. I definitely disagree. This is a copout by the regulators. Whether it is direct or indirect, if you put a burden on that small businessowner, then he should have some relief. So I totally disagree that your proposal is burdensome.

Mr. **SATAGAJ.** I concur. If you know that there is a burden out there and you just say it is burdensome, then I think it is a lousy deal to say just let the small business deal with it, so I would agree as well.

Senator **WALLOP.** There is an interesting old sociological theory that institutions in conflict can, after a period of time, join or marry each other, and so put their conflicts to rest. That is very easy for big business to do, and it is one of the reasons why small business has been knocking their socks off in both production and employment in this country. It is one of the reasons why you find big business less inclined to contest mandatory benefit requirements than small business, because for one reason or another they sort of have already gotten themselves into that kind of posture.

Those who have this great cry that America is wasting and no longer competitive continue to add impediments in the path of increasing competitiveness. You mentioned it, Mr. Browning.

Is it your view that this would be a step in restoring some level of competitiveness?

Mr. **BROWNING.** Absolutely. Anything that will reduce overhead and nonproductive time will increase America's competitiveness.

Senator **WALLOP.** So that they can spend their genius on product rather than——

Mr. **BROWNING.** Absolutely. What so many times I think is overlooked is they feel that this is only 1 or 2 percent, but when you multiply that by the hundreds of firms that are involved in any product that we take to the marketplace and if you total that up, then you have a much bigger slice of costs that are wasted. A few percentage points can mean the difference between America being competitive and losing out.

Senator **WALLOP.** Some in those advocacy offices in Washington, and you know who they are, would claim that this is just a cry on behalf of small business to avoid social responsibility. How do you respond?

Mr. **SATAGAJ.** Actually, I think it is to the contrary. The purpose of this law is not to "not regulate." This law is to regulate flexibly. I think we take a very responsible role as citizens as well as small businesses, so my response is we are not asking "not to regulate," but let us do so in a flexible, logical way.

I think it is important. We are trying to be responsible citizens, and we understand priorities.

Mr. **BROWNING.** Your small business people are much more socially responsible because they have to eyeball an employee when they come in. When you go into a plant and you are a card and you are a number, then you can deal with it; but when you have to look that person in the face every morning and tell them this I can provide or I cannot, you will find your small business is much more responsible socially than any large business, regardless of all the programs, all the coordinators, and all the fancy titles that may be provided.

Senator WALLOP. Those are important points to make and a good point, I think, to end upon.

Do you have any more?

It is my own view, having been a small businessman in several dimensions in my former life that communities are important. The communities in which we live are important to us. The really bad operator does not live very long in a community. So it is with a plea to be relieved from social responsibility, whether it is environmental or health-related or tax-related or other things, just to have some sense of how these things affect the ability of America's commerce and production to go forward.

So thank you both very much, and I thank all the panelists this morning.

Senator Levin would like to have a statement inserted in the record, and that will be done as if he had been here.

[The prepared statement of Senator Levin follows:]

Statement of Senator Carl Levin
Committee on Small Business
Hearing on the Regulatory Flexibility Act of 1980
October 17, 1989

Mr. Chairman, I came to the Senate directly from local government. As a former Detroit City Council President, I am all too familiar with the difficulties local governments face in responding to demands put on them by federal agencies. This burden is great for large metropolitan areas such as Detroit, but it can be overwhelming for those small governments which constitute a majority of the local governments in the nation.

This experience can be easily translated to small business. Small businesses many times do not have access to complex computer systems or specialized legal representation. Yet, we treat them as they do. This jeopardizes one of the most vital sources of innovation and growth in our economy.

Federal agencies so easily forget that small entities oftentimes, have very limited access to technical experts, legal counsel, or even computers to respond to the demands placed on them by federal regulatory programs. An increase in duties for these small entities can mean great financial difficulty, overburdened personnel, or, as a last resort, noncompliance with the regulation. Yet our federal agencies so often treat them as if they had the capabilities of a large organizations or companies.

That's why we passed the Regulatory Flexibility Act -- to force federal agencies to take the limitations of small entities into account in issuing regulations. Unfortunately, the implementation and enforcement of the Act has been much less than satisfactory.

As a member of the Governmental Affairs Committee, I was an active participant in that Committee's oversight hearing on the Regulatory Flexibility Act held in September of 1988. As a result of issues raised at that hearing, my staff and I worked with Senator Glenn and his staff on legislation aimed at strengthening the Regulatory Flexibility Act with regard to small, local governments. Senator Glenn introduced this legislation yesterday as S. 1758, The Small Governments Regulatory Partnership Act of 1989.

S. 1758 is a good start to ensuring agency sensitivity to the limitations and concerns of small governments. However, more needs to be done to ensure agency sensitivity to the limitations and concerns of small entities in general.

I am pleased that the Small Business Committee has choosen to review the Regulatory Flexibility Act of 1980 and

Senator Wallop's legislation, S. 1458. I hope the two committees can work together to achieve regulatory relief for this nation's small businesses and small governments.

Senator **Wallop**. Thank you. This hearing is adjourned.

[Whereupon, at 11:37 a.m. the hearing was adjourned.]

APPENDIX

Written Statement of
THE ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COMPANIES

Before the
Senate Committee on Small Business
United States Senate

October 25, 1989

The Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO) is a national trade association of more than 400 independently owned and operated telephone systems serving rural areas of the United States and Canada. Our members, which include both commercial companies and cooperatives, range in size from less than 100 to 50,000 access lines and together serve nearly 2 million customers. OPASTCO appreciates the opportunity to present to the Committee its views on the Regulatory Flexibility Act[1] as it affects small telephone companies.

At the time of its enactment, the RFA offered some relief to small businesses, ensuring that the concerns of small businesses are considered when the government undertakes an action. However, the RFA cannot have the full effect that was intended without the addition of judicial review. Currently, agencies need only acknowledge compliance with the RFA; they need only go through the motions. Agencies' rulemaking proceedings are subject to review by the United States Court of Appeals. However, the question as to whether an agency is in compliance with the RFA is not subject to any further investigation by another body. An agency need only say that it is in compliance and the matter is closed. OPASTCO is uncertain whether allowing for judicial review of agency adherence to the RFA will slow down the regulatory process; however, OPASTCO is certain that it will ensure that an agency has adequately determined whether their regulations do have a significant economic impact on a substantial number of small entities.

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[1] Regulatory Flexibility Act, 5 U.S.C. Sec. 601-612 (1977, and supp. 1989) (RFA).

The process of complying with the RFA has essentially become automatic for government agencies. In other cases, the process of judicial review, by its very existence, ensures that a different entity's viewpoints can be taken into consideration.

In February 1986, the United States Telephone Association (USTA) petitioned the Federal Communications Commission (FCC or Commission) to reduce the administrative and regulatory burdens on small telephone companies and to amend part 61 of the Commission's Rules.[2] The Commission had reduced or eliminated tariff filing requirements for non-dominant common carriers, including such carriers as MCI and U.S. Sprint, in its Competitive Carrier Docket.[3] However, the FCC had classified all independents, regardless of size, as dominant carriers because they "share in AT&T's market power."[4] The independent carrier classification includes the Bell companies that have millions of access lines as well as small systems that may have less than one hundred access lines. The Commission said that local telephone companies, regardless of size, will continue to be classified as dominant until the time that actual competition develops in the local market to the extent necessary to warrant reconsideration of the issue.[5]

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[2] USTA Petition, February 18, 1986.

[3] Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Report and Order, 91 FCC 2d 59 (1982), reconsideration denied, 93 FCC 2d 54 (1983); Further Notice of Proposed Rulemaking, 47 Fed. Reg. 17,308 (1982); Third Further Notice of proposed Rulemaking, 48 Fed. Reg. 28,292 (1983); Fourth Further Notice of proposed Rulemaking, 49

On June 29, 1987, the FCC released its Report and Order CC Docket No. 86-467 In the Matter of Regulation of Small Telephone Companies in response to USTA's petition. The Commission stated that the commenters in the proceeding did not prove that small telephone companies should be classified as non-dominant, but that all local telephone companies, even the smallest independent carriers, have market power and therefore should be regulated as dominant carriers. The Commission's Report and Order stated that "small telephone companies were excluded from the definition of

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Fed. Reg. 11,856 (1984); Fifth Report and Order, 98 FCC 2d 1191 (1984); Sixth Report and Order, 50 Fed. Reg. 1215; 57 R.R. 2d 1391 (1985); Vacated and remanded, MCI Telecommunications Corp. v. FCC, No. 85-1030, slip op. (DC Cir. July 9, 1985).

[4] First Report and Order, 85 FCC 2d at 24.

[5] The advent of actual competition and thus reconsideration, may be in the near future. In its price caps proceeding, (Report and Order and Second Further Notice of Proposed Rulemaking CC Docket No. 87-313, April 17, 1989, p. 272) the Commission determined that the development of shared tenant systems, private networks, and other technologies suggests an increase in competition for access services and that more competition is likely to develop. The Commission said that evidence suggests that the future prospects for competition for LEC services are significant.

'small entity' in Section 3 of the Small Business Act because the Section excluded any entity that is dominant in its field of operation." Based on this, the Commission concluded that the RFA did not apply to the rulemaking.[6]

These decisions regarding regulation of small carriers and the RFA were made by the predecessors of the current members of the Commission. In the past, small telephone companies have been able to work with the FCC to educate its members on issues concerning the needs and special considerations of small telephone systems. The Commission's approach to the issues such as price caps, simplification of accounting procedures, and average schedule-type settlements indicates recognition of small telephone company concerns. OPASTCO would like to work with the new FCC chairman and commissioners to aid in their further understanding of small company issues as well.

As of the first of this year, more than 3/4 of the states had taken action to remove some local telco services from the traditional rate base, rate of return method of regulation.[7] Half of those states that have yet to reduce regulation are considering some sort of regulatory reform. Types of reform range from the very conservative to the most radical. The states of Arkansas, Oklahoma, and Pennsylvania have limited their deregulation to a single service, billing and collection. On the other hand, Nebraska's radical restructuring is a direct product of state legislation. Basic local service is currently price capped, and all other services are deregulated. The caps expire in 1991, and basic service will be deregulated. In 1988, the state of Ohio passed into law a deregulatory bill which allows the PUC to propose alternatives to rate of return regulation (implementation requires consent of the companies involved), and permits the PUC to end all price and profit regulation for telephone companies under 15,000 lines.

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[6] Report and Order CC Docket No. 86-467, June 29, 1987.

[7] State Telephone Regulation Report Vol. 7, No. 1, January 12, 1989.

OPASTCO believes that for the RFA to be effective, it must contain judicial review to prevent agencies from only giving lip service to compliance. OPASTCO would like to work with the new Commission to come to an understanding about small local exchange carrier issues and concerns.

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